Supreme Court, U.S.
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No. ____

In the Supreme Court of the United States

RITA J. McCONVILLE,

Petitioner,

v.

THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. If a corporation files a misleading Form 10-K with the Securities and Exchange Commission, can that filing constitute a violation of §10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §78j(b) and Rule 10b-5, 17 C.F.R. §240.10b-5, by an individual who did not prepare, sign, file, or disseminate that Form 10-K?

2. Is a court's review under §25 of the Exchange Act, 15 U.S.C. §78y, so deficient as to require an exercise of this Court's supervisory powers when the court affirms an SEC order directing the petitioner to cease and desist from violating Exchange Act §§10(b) and 13(b)(5) and SEC Rules 10b-5, 13b2-1 and 13b2 2 and from causing an issuer to violate other securities laws, even though:

(a) the reviewed order is based on facts different from those alleged in the SEC's order instituting proceedings;

(b) the SEC did not identify any accounting record falsified in violation of Rule 13b2-1;

(c) the finding that the petitioner lied to auditors while an officer of an issuer in violation of Rule 13b2-2 is based on statements of subjective belief made after the petitioner ceased to be subject to the Rule;

(d) the issuer was not joined as a party as required by Exchange Act §21C; and

(e) the court relied on facts and reasoning different from the facts and reasoning the SEC relied on to find a violation of Exchange Act §13(b)(5)?

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PETITION FOR A WRIT OF CERTIORARI

Rita J. McConville ("McConville") petitions the Court to issue a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in its Case No. 05-3510.

OPINIONS BELOW

The Court of Appeals' Opinion is published at 465 F.3d 780 and unofficially reported at Fed. Sec. L. Rep. ¶ 93,969. The Opinion and Order of the United States Securities and Exchange Commission are reported at S.E.C. Release No. 51950. The Initial Decision rendered by the Commission's Chief Administrative Law Judge is reported at 83 S.E.C. Docket 2694.

JURISDICTION

The Court of Appeals' decision was rendered on October 11, 2006. McConville's timely petition for Rehearing or Rehearing En Banc was denied on January 17, 2007, within 90 days of this Petition. This Court has jurisdiction pursuant to 28 U.S.C. §1254(1).

STATUTES AND REGULATIONS INVOLVED

Pursuant to Supreme Court Rule 14.1(f), relevant texts of 15 U.S.C. §§78j, 78m, 78u-3, and 78y and 17 C.F.R. §§240.10b-5, 240.12b-20, 240.13a-1, 240.13b2-1, and 240.13b2-2 are reproduced at Appendix E.

STATEMENT OF THE CASE

A. Procedural History. This case arises from an administrative enforcement proceeding conducted by Respondent, the United States Securities and Exchange

Commission ("SEC" or "Commission") pursuant to §21C of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §78u-3. The SEC held McConville violated its Rule 10b-5, 17 C.F.R. §240.10b-5, and Exchange Act §10(b), 15 U.S.C. §78j(b), based on her involvement with a misleading Form 10-K filed by Akorn, Inc. ("Akorn"). It also ruled McConville: failed to implement a system of internal controls at Akorn, violating Exchange Act §13(b)(5), 15 U.S.C. §78m(b)(5); caused Akorn's accounting records to be falsified, violating SEC Rule 13b-1, 17 C.F.R. §240.13b-1; made misstatements to Akorn's auditors, violating SEC Rule 13b2-2, 17 C.F.R. §240.13b2-2; and caused Akorn to violate several other securities laws. The Commission entered a cease and desist order against McConville.

McConville unsuccessfully petitioned the United States Court of Appeals for the Seventh Circuit to set aside the Commission's order pursuant to Exchange Act §25, 15 U.S.C. §78y.

B. Synopsis of Underlying Facts. McConville was Akorn's Chief Financial Officer ("CFO") from 1997 until March 20, 2001. She remained on Akorn's payroll until July 2001. Akorn's stock was publicly traded during McConville's employment there.

During McConville's tenure as CFO, management of Akorn's accounts receivable was in disarray. Akorn's accounting software (purchased under the auspices of McConville's predecessor) and its accounting personnel could not handle the volume and complexity of its accounts receivable. Akorn purchased new accounting software in 2000, and implemented it at the outset of 2001, but its effectiveness was prospective only.

This is not a case in which a company or its personnel "cooked the books." No one alleged that Akorn recorded fictitious sales or payments, or otherwise manipulated its accounts to create a false impression of its financial condition. Indeed, the evidence was that at a general ledger level—i.e., the level from which Akorn's published financial statements were prepared—Akorn's accounting records were accurate. Its financial statements correctly reported its gross sales and gross cash receipts. The disarray was at the sub-ledger level, where Akorn tracked individual invoices and credits.

The financial reporting issue at the heart of this case concerns Akorn's assessment of the impact the disarray in its accounts receivable records had on its ability to collect. Akorn's software and personnel did not consistently and timely match payments and credits with the right invoices. Consequently, while Akorn knew (and accurately reported) the aggregate amount of its outstanding invoices, it did not have a clear understanding of which specific invoices had been paid and which specific credits had been claimed by customers. Collecting the receivables and gauging their collectibility in this circumstance was more difficult than it would otherwise have been.

Akorn's accounts receivable grew at a rate greater than its sales volume. Cash flow slowed. Akorn fell out of compliance with certain financial covenants with its lenders. In February 2001, the lenders expressed alarm to Akorn's Chairman and controlling shareholder, Dr. John Kapoor.

Kapoor engaged a consultant to evaluate Akorn's accounts receivable management. On March 20, 2001, five days after the consultant delivered a report describing his preliminary assessment, Kapoor convened a special meeting of Akorn's Board of Directors. The minutes show that Kapoor told the Board additional personnel were being brought in to review

Akorn's accounts and assess the need for charge offs. Akorn's Board removed McConville and the company's chief executive from office, installed a CPA named Kevin Harris ("Harris") as Akorn's new CFO, and installed Kapoor as chief executive officer. McConville remained in Akorn's employ until July 2001, working under Harris and the consultant to reconcile a $5 million difference between Akorn's accounts receivable records and those of its largest customer.[1]

On April 17, 2001, Akorn filed its year-2000 annual report on Form 10-K with the Commission. Akorn reported net income of $2.2 million for 2000. Akorn's controller, Thomas Costello, was responsible for preparing the document. *See In re Costello,* ¶ 10.[2] Kapoor, Harris, and each of Akorn's directors signed the Form 10-K. McConville did not sign, file, or otherwise disseminate the 10-K.

Also on April 17, McConville signed two management representation letters to Akorn's auditors, articulating her subjective belief about the accuracy of Akorn's financial statements.

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[1] The Seventh Circuit stated that, after she was removed from office on March 20, 2001, "McConville also continued her work . . . compiling the figures for Akorn's 2000 fiscal year audit for the financial statements that would be filed with the SEC." *McConville,* 465 F.3d at 784, App. 9a. In fact, Akorn's controller and his staff, performed the compilation, *See, In re Thomas D. Costello,* SEC Release Case No. 48906 ¶9 (Dec. 11, 2003)("*In re Costello*"). The compilation was done, and audit fieldwork on it was completed, by February 23, 2001. *In re Rita J. McConville,* SEC Release Case No. 51950, Slip Op. at 9, App. 37a (June 30, 2005) ("*In re McConville*").

[2] Harris prepared the disclosures concerning events subsequent to February 23, 2001. McConville drafted the description of Akorn's stock option and stock purchase plans.

On May 16, 2001, Akorn announced it was increasing several accounting reserves. One of the increased reserves was for uncollectible accounts receivable. In its 2000 Form 10-K, Akorn estimated that $800,000 of its accounts receivable would be uncollectible. Its new estimate was $8.3 million.

C. The SEC's Proceedings. Akorn's announcement precipitated an SEC investigation. The investigators concluded the change in Akorn's receivables reserve resulted from the disarray in its receivables management.[3] They believed the impact of the disarray should have been reflected in Akorn's 2000 Form 10-K.

The Commission entered an Order Instituting Proceedings against McConville and Harris (the "OIP").[4] App. D. It alleged that Akorn's 2000 Form 10-K was false in the following respect:

> Had Akorn appropriately recorded a reserve for its doubtful accounts, it would have posted a $2 million loss for its fiscal year ended December 31, 2000, rather than the $2 million profit it claimed in its 2000 Form 10-K.

App. 72a, ¶ H. The OIP further alleged that McConville had reviewed a draft of the Form 10-K that did not differ significantly from the document Akorn ultimately filed, and that she falsely represented in letters to Akorn's auditors that its "allowances [for doubtful accounts receivable] are

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[3] Akorn attributed the change in its estimate to new information it received from customers that had previously evinced their willingness to pay their older invoices. *In re Costello*, ¶ 16; OIP, ¶ N, App. 73a-74a.

[4] Akorn settled with the SEC. *In re Akorn, Inc.*, SEC Release No. 48546 (September 25, 2003). The proceeding terminated as to Harris after the initial decision.

adequate to absorb currently estimated uncollectible receivables in the account balances" and that no events subsequent to February 23, 2001, needed to be disclosed in the Form 10-K. App. 72a–73a, ¶ K. It ordered an evidentiary hearing to determine whether McConville committed the violations charged in the OIP.[5]

The Commission ultimately concluded that McConville violated Rule 10b-5 and §10b. Contrary to the allegations in the OIP, however, the Commission did not find that Akorn's Form 10-K was false because it reported $2 million in net income instead of a $2 million loss. Instead, it found the Form 10-K was misleading because it did not include a footnote disclosing that Akorn's accounts receivable were impaired by an unquantifiable amount. *In re McConville*, Slip. Op. at 12–14, App. 42a-43a. Its holding that McConville violated Rule 10b-5 was *not* "based on statements to auditors that unexpectedly ended up in documents distributed to investors" as the OIP had implied. Rather, it was "based on misstatements and omissions in the financial statements contained in the 2000 Form 10-K filed with the Commission, which she was involved in drafting and reviewing." *In re McConville*, Slip. Op. at 17, App. 49a.

The Commission also held that McConville violated or caused Akorn to violate each of the other provisions of the securities laws listed in the OIP. McConville was ordered to cease and desist such violations.

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[5] McConville was charged with violating §§10(b) and 13(b)(5) of the Exchange Act, 15 U.S.C. §§78j(B), 78m(b)(5) and Rules 10b-5, 13b2-1, and 13b2-2, 17 C.F.R. §§240.10b-5, 240.13b2-1 and 240.13b2-2. Akorn's violations allegedly caused by McConville consisted of violations of §§ 13(a) and 13(b)(2) of the Exchange Act, 15 U.S.C. §§78m(a), 78m(b)(2), and Rules 12b-20 and 13a-1,17 C.F.R. §§240.12b-20 and 240.13a-1. OIP ¶ P, App. 74a.

McConville petitioned the Seventh Circuit for relief pursuant to Exchange Act §25, 15 U.S.C. §78y.

D. The Seventh Circuit's Proceedings. In the Seventh Circuit, McConville disputed the sufficiency of the evidence supporting the Commission's findings. She argued that the Commission's application of Rule 10b-5 and §10(b) was erroneous in light of this Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), as applied by the United States Courts of Appeals for the Second, Tenth, and Eleventh Circuits in *Wright v. Ernst & Young LLP*, 152 F.3d 169 (2d Cir. 1998), *Anixter v. Home-Stake Production Co.*, 77 F.3d 1215 (10th Cir. 1996), and *Ziemba v. Cascade International, Inc.*, 256 F.3d 1194 (11th Cir. 2001). She contested the propriety of the Commission's holdings that she violated Rules 10b-5 and 13b2-2 and §10(b) based on facts different from those alleged in the OIP. She disputed the correctness of the Commission's construction and application of §13(b)(5). And she again challenged the Commission's authority under §21C to order her to cease and desist from causing securities law violations without joining the alleged violator in the proceeding or the cease and desist order.

The Seventh Circuit found its pre-*Central Bank* decision in *SEC v. Holschuh*, 694 F.2d 130 (7th Cir. 1982), controlling on the scope of conduct proscribed by §10(b) and Rule 10b-5. It opined that it does not matter whether a respondent personally communicated a false or misleading statement of material fact to investors "so long as the requisite intent was established." *McConville*, 465 F.3d at 787, App. 14a. Because McConville did not sign or disseminate the subject financial statements, the court identified the determinative issue as "whether she *caused* Akorn to make material misstatements to the investing public." *Id.* (emphasis added). Thus, the court essentially evaluated whether

McConville caused Akorn to violate §10(b), even though no such Akorn violation was alleged.

To answer that question in the affirmative (and thereby uphold the Commission's conclusion that McConville had violated Rule 10b-5 and §10(b)) the court relied on the same statements McConville made to Akorn's auditors that the Commission expressly disclaimed as the basis for its holding McConville had violated §10(b) and Rule 10b-5. *Compare Id.* at 787-88; App. 15a-16a ("[I]n a February 23, 2001 letter to Deloitte . . . In Akorn's April 17, 2001 letter to Deloitte . . . ."), *with In re. McConville*, Slip. Op. at 17, App. 49a ("Her liability under §10(b) and Rule 10b-5 is not based on statements to auditors . . ."). The court concluded that "McConville's failure to disclose the impairment [of Akorn's accounts receivable] in Akorn's financial statements violated Rule 10b-5." *McConville*, 465 F.3d at 787, App. 15a.

The Seventh Circuit variously ignored or rejected McConville's challenges to the Commission's conclusions that she violated and caused Akorn to violate other securities laws. It never discussed whether, under §21C, the SEC is authorized to enter cease and desist orders for causing violations of the securities laws without joining the alleged violator as a party and finding the respondent proximately caused the violations. It largely ignored her objections that (1) the Commission's holdings on Rules 10b-5 and 13b2-2 and §10(b) were based on facts different from those alleged in the OIP, (2) the Rule 13b2-2 charge was predicated upon statements expressly couched as a statements of subjective belief, not shown to be different than McConville's actual belief, which were made only after the Rule ceased to apply, (3) no record falsified in violation of Rule 13b2-1 was identified, and (4) the Commission incorrectly construed and applied §13(b)(5).

When McConville petitioned for rehearing, the court responded by amending its opinion to add a footnote, stating that McConville was not being found liable under an aiding and abetting theory, but noting that in any event in certain actions brought by the SEC, liability attached to "any person that knowingly provides substantial assistance to another" in violation of the statute and cited 15 U.S.C. §78t(e). McConville, 465 F.3d at 787 n.11, App. 2a. The court did not acknowledge that administrative proceedings under §21C of the Exchange Act are not covered by 15 U.S.C. §78t(e) (which applies only to actions filed in federal district courts) and that the Commission never alleged that McConville "caused" Akorn to violate Rule 10b-5.

REASONS FOR GRANTING THE WRIT

1. The Seventh Circuit's Decision Conflicts With Decisions Of Other Circuits On An Important Issue Of Federal Securities Law, And Resolution Of That Conflict Will Aid In Deciding *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, No. 06-43, *cert granted*, 75 USLW 3034 (March 26, 2007).

The Seventh Circuit's decision conflicts with decisions by the Second, Sixth, Tenth, and Eleventh Circuits on the important question of whether sub-part (b) of Rule 10b-5 proscribes any conduct other than using the jurisdictional means to make false or misleading statements of material fact in connection with the purchase or sale of securities. This question is closely tied to the issue presented under sub-parts (a) and (c) of Rule 10b-5 in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, No. 06-43, *cert granted*, 75 USLW 3034 (March 26, 2007).

In fact, the issue presented in *Stoneridge* is an outgrowth of the Rule 10b-5(b) issue presented here. Consequently,

determining whether the Seventh Circuit properly construed and applied Rule 10b-5(b) will aid in resolving the question presented in Case No. 06-43, *i.e.*, whether the Eighth Circuit correctly applied *Central Bank* to Rule 10b-5(a) and (c). Taken together, this case and *Stoneridge* provide an opportunity to comprehensively resolve the splits of authority that have developed as the lower courts have endeavored to apply *Central Bank* to each of the three sub-parts of Rule 10b-5.

A. There Is A Split Of Authority Over What Conduct Violates Rule 10b-5(b) After *Central Bank*.

In *Central Bank*, this Court held that persons who merely aid or abet violations of Rule 10b-5 and §10(b) cannot be held liable under those provisions in private civil actions. Since that decision, numerous federal courts have addressed whether specific types of conduct actually violate Rule 10b-5 and §10(b) or constitute mere aiding and abetting.[6] With respect to violations of Rule 10b-5(b), two conflicting lines of authority have developed.

Shapiro v. Cantor, 123 F.3d 717 (2d Cir. 1997) typifies one of those lines. There, the Second Circuit held that "[the] defendant must actually make a false or misleading statement in order to be held liable under §10(b)." *Id.* at 720. "Anything short of such conduct" the court continued "is merely aiding and abetting, and no matter how substantial that

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[6] *Compare, e.g., In re Elan Corp.*, Case No. 02CV865, 2004 WL 1305845, at *26 (S.D.N.Y. May 18, 2004) (applying bright line test); *In re Rent-Way Sec. Litig.*, 209 F.Supp.2d 493, 503 (W.D. Pa. 2002) (same); *Winkler v. NRD Min., Ltd.*, 198 F.R.D. 355, 364 (E.D.N.Y. 2000) (same) *with In re ZZZZ Best Sec. Litig.*, 864 F.Supp. 960, 970 (C.D. Cal. 1994) (applying substantial participation test); *Cashman v. Coopers & Lybrand*, 877 F.Supp. 425, 432-34 (N.D. Ill. 1995) (same) *McNamara v. Bre-X Minerals Ltd.*, 57 F.Supp.2d 396, 426 (E.D. Tex. 1999) (same).

aid may be, it is not enough to trigger liability under §10(b)." *Id.* This analysis is referred to as the "bright line" test.

The other line of authority is rooted in *In re Software Toolworks*, 50 F.3d 615 (9th Cir. 1994). There, the Ninth Circuit reversed an order granting summary judgment to accountants alleged to have violated Rule 10b-5 and §10(b) through their substantial involvement with a misleading prospectus issued in a secondary offering of securities. The accountants did not issue the prospectus. They had, however, prepared letters to the SEC and were identified in letters to the SEC as a point of contact for inquiries as its staff reviewed the prospectus. The court held those letters might be a sufficient basis for finding the accountants had violated §10(b). From this precedent, a second and conflicting line of cases has emerged, holding that "substantial participation" in the preparation of false or misleading statements made by others violates Rule 10b-5 and §10(b). *See SEC v. Lucent Tech., Inc.*, 363 F.Supp.2d 708, 719-24 (D.N.J. 2005).

Since *Central Bank,* the majority of circuit courts to have considered whether substantial participation with someone who makes a false or misleading statement violates Rule 10b-5(b) and thereby §10(b) have concluded it does not. *See Fidel v. Farley*, 392 F.3d 220, 226 (6th Cir. 2004); *Ziemba*, 256 F.3d at 1206; *Wright*, 152 F.3d at 175; *Anixter*, 77 F.3d at 1226. The Seventh Circuit's decision created a 4-2 split between the circuits that have addressed this question under Rule 10b-5(b). It acknowledged McConville did not make the statement the SEC found to be misleading. *McConville*, 465 F.3d at 787, App. 15a. It reiterated its pre-*Central Bank* observation that "'actual or first-hand contact with offerees or buyers [is not] a condition precedent to primary liability for antifraud violations,' so long as the requisite intent [is] established." *Id.* (quoting with approval *Holschuh*, 694 F.2d at 142). It held the relevant inquiry was "not whether

McConville (quite literally) delivered the misleading statements to the SEC, but whether she caused Akorn to make material misstatements to the investing public." *Id.*

That analysis not only conflicts with the "bright line" test adopted in the majority of circuits, it is also inconsistent with both §10(b)'s text and this Court's precedents. In §10(b), Congress proscribed using the jurisdictional means to use or employ, in connection with the purchase or sale of a security, manipulative or deceptive devices or contrivances. The Commission cannot expand the scope of the prohibition to encompass other conduct. *Cf. Central Bank*, 511 U.S. at 177 ("It is inconsistent with settled methodology in §10(b) cases to extend liability beyond the scope of the conduct prohibited by the statutory text."). But the Seventh Circuit's determination that McConville violated Rule 10b-5, and thus §10(b), effectively reads elements of the offense Congress defined out of §10(b).

Even assuming McConville's actions were the proximate cause of Akorn's employment of a deceptive device—i.e., the publication of misleading financial statements—there was no evidence that (i) using the jurisdictional means, (ii) McConville personally made a false or misleading statement (Rule 10b-5(b)), and thereby employed a deceptive device (§10(b)), (iii) in connection with the purchase or sale of securities. Nor was there evidence that her "causing" actions involved jurisdictional means or were in connection with the purchase or sale of securities.

There must be a duty to speak before an omission violates §10(b). *Chiarella v. United States*, 445 U.S. 222 (1980). The Seventh Circuit clearly viewed this as an omissions case. *McConville*, 465 F.3d at 787, App. 15a ("McConville's *failure to disclose* the impairment in Akorn's financial statements violated Rule 10b-5.") (emphasis added). But it

not only failed to articulate any source of McConville's duty to speak, it expressly rejected the very idea that facts showing she had no such duty were relevant to its inquiry. *Id.*

It is uncontroverted that McConville did not sign, file, or disseminate the Form 10-K. The Form 10-K does not attribute its contents to her. When the Form 10-K was filed, McConville held no Akorn office—much less an office whose duties included preparing, signing, filing, or disseminating the Form 10-K. She was not trading in Akorn stock. There was not even evidence that she derived some indirect benefit by virtue of the Form 10-K's description of Akorn's financial condition.[7] Because McConville had no duty to disclose an impairment of Akorn's accounts receivable when it filed its 2000 Form 10-K, it was erroneous to hold that she violated Rule 10b-5 and §10(b) by failing to make such a disclosure.

The Exchange Act's enforcement provisions confirm that §10(b) was not intended to prohibit causing others to make misleading statements. Congress specifically dealt with those who "cause" others to violate §10(b) in Exchange Act §21C, 15 U.S.C. §78u-3. It extended liability to controlling persons, and aiders and abettors through Exchange Act §20, 15 U.S.C. §78t. These provisions would be pure surplus under the Seventh Circuit's expansive reading of §10(b).

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[7] McConville did not, for example, receive a bonus for 2000 based on the financial results reported in the Form 10-K. In fact, her 2001 salary (like that of Akorn's other senior mangers) was reduced by 20% as compared to 2000 even before she was removed as Akorn's CFO.

B. The Circuit Split Over Rule 10b-5(b) Involves An Important Question Of Federal Securities Law That This Court Should Resolve.

Today, it is clear in the Second, Sixth, Tenth, or Eleventh Circuits that only persons who use the jurisdictional means to make false or misleading statements of material fact in connection with the purchase or sale of securities can be found to have violated Rule 10b-5(b). In the Seventh and Ninth Circuits, substantial participation—exactly how much is unclear—in another's violation may violate the Rule.

Certainty, predictability, and uniformity of rules determining what conduct violates the federal securities laws, particularly Rule 10b-5 and §10(b)—is of great importance. *See, e.g., Central Bank,* 511 U.S. at 188 (quoting *Pinter v. Dahl,* 486 U.S. 622, 652 (1988)). Given the lack of a clearly defined standard in the Seventh and Ninth Circuits, this Court should grant this Petition and resolve the split of authority in favor of the "bright line" test described above.

C. Resolving the Circuit Split Over Rule 10b-5(b)'s Reach Will Assist In Deciding *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*

Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., No. 06-43, presents the question of whether persons who knowingly engage in sham transactions with an issuer, expecting the issuer to then issue false or misleading financial statements because of its improper accounting for the transactions, violate sub-parts (a) and/or (c) of Rule 10b-5, 17 C.F.R. §240.10b-5(a),(c). Prior to *Central Bank,* if securities claims for such conduct were brought, they could be expressly predicated on Rule 10b-5(b) violations. Instead of alleging the issuer's commercial partners committed the specialized types of securities fraud historically thought to be

proscribed by sub-parts (a) and (c) of Rule 10b-5, plaintiffs (or regulators) could argue that the commercial partners aided and abetted the issuer's fraud proscribed by Rule 10b-5(b). *See, e.g., Allstate Life Ins. Co. v. Linter Group Ltd.*, 782 F.Supp. 215, 218-19 (S.D.N.Y. 1992); Nicholas Schanbaum, *Scheme Liability: Rule 10b-5(A) and Secondary Actor Liability After Central Bank*, 26 REV. LIT. 183, 188-89 (2007).

Once this Court ruled that aiding and abetting a §10(b) violation could not sustain liability in private securities litigation, it became more clear that persons who engaged in conduct of the sort alleged in *Stoneridge* were unlikely to be found liable under Rule 10b-5(b). It is, however, feasible to label such conduct as intrinsically and intentionally deceptive or manipulative, in a non-technical sense. Such conduct is arguably proscribed by §10(b) (if its terms are interpreted without reference to the technical meanings ascribed to them at common law. *See Hundahl v. United Benefit Life Ins. Co.*, 465 F.Supp. 1349, 1360 (N.D. Tex. 1979)). Because Rule 10b-5(a) prohibits employment of any device, scheme, or artifice to defraud, and Rule 10b-5(c) forbids engaging in any act, practice, or course of business that operates as a fraud or deceit in connection with the purchase or sale of securities, invoking those provisions could arguably circumvent the limits on Rule 10b-5(b) claims dictated by *Central Bank* and its progeny.

Plaintiffs in several cases have seized on that argument. As happened after *Central Bank* in conventional Rule 10b-5(b) cases, the circuits disagree whether conduct like that alleged in *Stoneridge* violates sub-parts (a) and/or (c) of Rule 10b-5. The Eighth Circuit concluded it does not. *In re Charter Communications, Inc. Sec. Lit.*, 443 F.3d 987 (8th Cir. 2006), *cert. granted, Stoneridge Invest. Partners, LLP v. Scientific-Atlanta, Inc.*, No. 06-43, ___ U.S. ___, 75 USLW

3034, 2007 WL 879583 (U.S.) (March 26, 2007). In reaching its conclusion, the Eighth Circuit looked to decisions addressing Rule 10b-5(b) violations for guidance. *Id.* at 992. The Fifth Circuit reached essentially the same conclusion in *Regents of University of California v. Credit Suisse First Boston (USA), Inc.*, ___ F.3d ___, 2007 WL 816518 (5th Cir. 2007), *petition for cert. filed,* __ USLW ____, No. 06-1341, (April 9, 2007). In contrast, the Ninth Circuit has held that one may assert a claim for violating Rule 10b-5(a) and/or (c) against persons who engaged in conduct similar to that alleged in *Stoneridge. Simpson v. AOL Time Warner, Inc.*, 452 F.3d 1040 (9th Cir. 2006), *petition for cert. filed,* 75 U.S.L.W. 3236 (Oct. 19, 2006) (No. 06-560). Just as the Eighth Circuit looked to Rule 10b-5(b) cases for guidance on the reach of Rule 10b-5(a), (c), the Ninth Circuit looked to its precedent in *In re Software Toolworks Inc.*

An examination of how the Seventh and Eighth Circuits respectively reached the conclusions that §10(b) was or was not violated when claims were asserted under Rule 10b-5's various subparts illustrates just how closely the question presented here is linked to the question presented in *Stoneridge*. Here, McConville pointed out that, having been removed as Akorn's CFO and not having signed, filed, or disseminated Akorn's Form 10-K, she had no duty to speak. Thus, under conventional understandings of §10(b), her involvement with Akorn's reporting process could not support a charge that she violated §10(b) when Akorn omitted a required disclosure from its Form 10-K. In the Seventh Circuit's view, however, it made no difference whether McConville had a duty to speak; the "fact" that she caused Akorn to make a misleading statement to the investing public was sufficient to violate §10(b), so long as she knew or was reckless in not knowing that Akorn's statement was misleading. 465 F.3d at 786-88, App. 14a-16a. The Eighth

Circuit, by contrast, held that absent a duty to speak, the *Stoneridge* respondents' alleged complicity in the issuer's false and misleading statements did not violate §10(b), irrespective of their understanding of the issuer's planned accounting treatment. *In re Charter*, 443 F.3d at 992.

This case and *Stoneridge* present closely related, important questions of securities law on which the circuit courts are divided. Given the diametrically opposed views expressed by the Seventh and Eighth Circuits about what factors are relevant to determining whether conduct does or does not violate §10(b) and Rule 10b-5, examination of the question presented in each case may materially aid in the resolution of the question presented in the other.

The Court should grant this Petition and review the decision below in conjunction with *Stoneridge*.

2. The Seventh Circuit's Decision Represents Such A Departure From The Accepted And Usual Course of Proceedings Required By Exchange Act §25 As To Require An Exercise Of This Court's Supervisory Power.

Cases involving a conflict between two sound federal policies are particularly appropriate for resolution by this Court. This Petition involves such a case. One policy is that of guaranteeing citizens' right to meaningful judicial review of administrative adjudications. The conflicting policy is one of judicial deference to administrative agency decisions. The fundamental task is determining the degree of deference compatible with meaningful review.

When federal laws are enforced in the first instance in administrative proceedings, only the respondent's right to review by an Article III court avoids an unconstitutional

deprivation of the right to due process of law. *See, Phillips v. Commissioner of Internal Revenue*, 283 U.S. 589, 596-97 (1931) (recognizing that postponement of judicial enquiry is not a denial of due process *if* the opportunity given for ultimate judicial determination of liability is adequate). *See also Note, Judicial Review of Agency Inaction*, 83 COLUM. L. REV. 627, 627 (1983). Because judicial review protects a fundamental right, reviewing courts must carefully examine claims that respondents in administrative adjudications have been prejudiced by errors committed by agencies acting in both prosecutorial and adjudicatory roles. *Office of Communication of United Church of Christ v. F.C.C.*, 465 F.2d 519, 524 (D.C. Cir. 1972).

In Exchange Act §25, Congress specified that courts reviewing decisions of the SEC pursuant to that law can "affirm or modify and enforce or . . . set aside the order in whole or in part." 15 U.S.C. §78y(3). The statute does not authorize courts to make new findings of fact to justify an otherwise defective order, or to sustain an order on grounds not articulated by the SEC. The reviewing court should determine whether the SEC's resolution was correct; it should not supply a new rationale for an incorrect resolution. *See America's Community Bankers v. FDIC*, 200 F.3d 822, 835 (D.C. Cir. 2000).

Congress also provided in Exchange Act §25 that courts are to uphold the findings of the Commission as to the facts, "if supported by substantial evidence." 15 U.S.C. §78y(4). But that is the only deference Congress directed courts to accord the Commission. Courts are not instructed to accept unsubstantiated Commission findings, nor are they instructed to blindly accept its interpretations of law.

Nothing in Exchange Act §25 suggests an implied repeal of the Administrative Procedures Act. *Compare* 5 U.S.C.

§554(b)(3) (requiring timely notice "of the matters of fact and law asserted") *with* 15 U.S.C. §78u-3 (requiring "notice and opportunity for hearing"). Persons charged with violating the securities laws are entitled to notice of the allegations against them and cannot be sanctioned for unalleged violations. *Jaffee & Co. v. S.E.C.*, 446 F.2d 387, 394 (2d Cir. 1971) ("[F]or the hearing requirement to have any meaning, the notice provision must be interpreted to require that respondent have 'fair notice' of the claim lodged against [her] 'and the grounds upon which it rests.'") (quoting *Conley v. Gibson*, 355 U.S. 41, 47 (1957)). This right is especially critical where—as here—the charges sound in fraud.

The Seventh Circuit did not apply these principles.

A. The Seventh Circuit Failed To Enforce McConville's Right To Notice Of The Charges Against Her.

The Commission deprived McConville of her statutory (and due process) right to notice of the charges against her in two respects. The SEC charged her with violating Rule 10b-5 and §10(b) because Akorn's 2000 Form 10-K falsely reported net income of $2 million instead of a net loss of $2 million. OIP ¶ H, App. 72a. It found, however, that she violated these laws because Akorn's Form 10-K failed to disclose an accounts receivable impairment. *In re McConville,* Slip Op. 13-14, App. 43a-45a. The SEC charged that McConville violated Rule 13b2-2, 17 C.F.R. §240.13b2-2 (prohibiting misrepresentations by corporate officers to auditors), based on two specifically quoted excerpts from letters to Akorn's auditors. OIP ¶ K, App. 72a-73a. The evidence showed (a) McConville expressed only her subjective views in those letters and (b) did not sign either letter until April 17, 2001—a month after she had been removed as an Akorn officer and

was thus not subject to Rule 13b2-2. The Commission justified its Rule 13b2-2 findings in part on statements in the letters not referenced in the OIP and unalleged oral statements to Akorn's auditors while McConville was still Akorn's CFO. *In re McConville*, Slip Op. 11, 21, App. 39a, 56a-57a.

McConville objected to the Commission's failure to provide proper notice and an opportunity to defend against the uncharged facts, citing the court to both the APA and *Jaffe*. The Seventh Circuit neither discussed nor redressed these violations of McConville's rights as required by Exchange Act §25.

B. The Seventh Circuit Failed To Examine The Propriety of the Commission's Conclusion That McConville Caused Akorn's Records To Be Falsified Even Though No Falsified Record Was Identified.

The Commission charged and found that McConville violated Rule 13b2-1, which prohibits falsifying or causing to be falsified certain books, records or accounts. 17 C.F.R. §240.13b2-1. Neither the OIP nor the SEC's Opinion identified any falsified book, record or account. App. 69a-77a; *In re McConville*, App. 23a-67a. The opinion simply asserts that Akorn had insufficient internal controls and notes that McConville failed to correct the deficiency. It then concludes that "by failing to correct [shortcomings in Akorn's internal controls], McConville caused the falsification of Akorn's records." *In re McConville*, Slip Op. at 18, App. 51a–52a.

McConville pointed out to the Seventh Circuit that the Commission had failed to identify—much less present evidence of—a single falsified book, record, or account at Akorn. The SEC's reasoning that one must have existed

because of shortcomings in Akorn's internal controls is fallacious.

Even a complete absence of internal controls would not mean that books, records or accounts were necessarily falsified. Where such controls are absent, conditions may exist in which falsification is easier to accomplish or less likely to be detected. But the *act* of falsification of records is something separate and distinct from the *condition* the SEC (incorrectly) found present at Akorn—an absence of internal controls.

Falsification is an affirmative act. *See, e.g.*, Oxford American Dictionary, 232 (Oxford Univ. Press, 1980) ("falsify - 1. to alter (a document) fraudulently."). . Neither the text of Rule 13b2 1 nor thc rclcase adopting it (44 F.R. 10964 (Feb. 23, 1979)) suggests the Rule was intended to address situations in which an issuer's sub-ledger accounts became outdated because its accounting software and personnel proved unable—as opposed to unwilling—to keep pace with its routine transactions.

The Seventh Circuit ignored these matters. It held the conclusion that McConville violated Rule 13b2-1 was justified because the Commission stated that "Akorn's accounts receivable did not accurately show what invoices had been paid or what amounts were still owing on particular invoices and therefore did not accurately and fairly reflect the transactions and dispositions of Akorn's assets." *McConville*, 465 F.3d at 789, App. 18a. That recitation was neither evidence nor descriptive of falsification.

To accord McConville due process of law and discharge its responsibility under Exchange Act §25, the Seventh Circuit had to determine whether there was substantial evidence of a falsification in violation of the Rule, and that McConville was

its cause. It made no discernible effort to do so, leaving McConville wrongly sanctioned for an unproven violation of Rule 13b2-1.

C. The Seventh Circuit Did Not Properly Evaluate Whether The Commission's Conclusion That McConville Violated Rule 13b2-2 Was Grounded In Fact.

The Commission's conclusion that McConville violated Rule 13b2-2 could only be sustained upon substantial evidence that, while an officer of Akorn, and as alleged in the OIP, McConville lied to Akorn's auditors in connection with their audit. 17 C.F.R. §240.13b2-2. Even the Commission recognized that the two statements which formed the basis for the charge were not made by McConville until after she was removed as Akorn's CFO. *In re McConville*, Slip Op. at 10, App. 38a. The Seventh Circuit, however, did not even acknowledge this fact. Instead, it treated the issue before it as simply whether McConville had made misstatements to Akorn's auditors. *McConville*, 465 F.3d at 785, App. 10a.

McConville also objected that the statements described in the OIP as false statements of fact made to Akorn's auditors were actually statements of her subjective beliefs and there was no evidence that she did not hold those beliefs when she made the statements. The Commission viewed both statements as untrue because it believed the estimate of uncollectible receivables stated in Akorn's 2000 Form 10-K was materially understated. But because McConville only expressed her subjective beliefs, the relevant issue was her actual state of mind, not the estimate's accuracy. The Seventh Circuit did not discuss the significance of the fact that McConville's letters were expressly couched as statements of her subjective beliefs. Through this device, it avoided

confronting the problem that there was no evidence McConville did not hold the beliefs expressed, and thus no evidence that she lied to Akorn's auditors.

The Seventh Circuit went further even than the Commission to create an appearance of propriety about the erroneous conclusion that McConville had violated Rule 13b2-2. It asserted—without evidentiary foundation or even the strength of an incorrect finding by the Commission for support—that Akorn's board had made McConville Akorn's "corporate controller" when it removed her as CFO.[8] Through this device, it implied that McConville was a corporate officer subject to Rule 13b2-2 even after she was actually removed from office. *McConville*, 465 F.3d at 784, App. 8a-9a. It further opined that statements she made to Akorn's auditors that were not mentioned in either the OIP or the Commissions' decision were false and thus in violation of the Rule. *Compare* OIP ¶ K, App. 72a-73a, *with In re McConville*, Slip Op. at 11, 21, App. 39a, 57a, *and with McConville*, 465 F.3d at 785, 787, 789, App. 10a, 15a-16a, 19a.

Nothing in Exchange Act §25 permits the court to affirm the SEC's order by relying on facts other than those the SEC relied on. That it found the need to do so demonstrates that McConville was not afforded the careful and independent review of the Commission's order to which she was entitled. *See America's Community Bankers*, 200 F.3d at 835.

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[8] The evidence of the Board's action – its minutes – refute the notion that Akorn's board appointed her to any office when it removed her as CFO. There was no dispute that Costello, Akorn's controller on March 20, 2001, continued as Akorn's controller until he left Akorn in 2002. *In re Costello*, ¶ 1. Similarly, there was no dispute that under controlling state law, only Akorn's board could make McConville a corporate officer. La. Rev. Stat. §82-A(1)(1994).

D. The Seventh Circuit Never Considered the Limits of The Commission's Authority Under Exchange Act §21C.

McConville disputed the Commission's jurisdiction to order her to cease and desist from causing Akorn to violate the securities laws when Akorn was not joined in the Order. She also objected to the Commission's findings that she caused Akorn's violations because there was no substantial evidence she was the proximate cause of any violations Akorn committed. The basis for these points is the text of Exchange Act §21C, 15 U.S.C. §78u-3, which authorized the SEC to issue cease and desist orders.

Section 21C authorizes the SEC to issue "*an* order" against any person who has violated the securities laws "*and* any other person that is, was, or would be a *cause* of the violation." 15 U.S.C. §78u-3 (emphasis supplied). A fundamental principle of statutory construction, *expressio unis est exclusio alteris,* compels the conclusion that Congress' specification of the singular ("*an order*") and use of the conjunctive ("*and* any other person") forecloses an interpretation of the statute permitting an order to be issued *only* against a person "that is, was, or would be a cause of the violation." The statute requires joinder of the primary violator for an order to issue against a person who causes the violation.

The Commission insisted otherwise. The fact that "[t]he Commission has never construed §21C as having such a requirement" was the sole justification offered for its view. *In re McConville*, Slip Op. p. 27, n. 69, App. 66a.

McConville also pointed out that "[w]here Congress uses terms that have accumulated settled meaning under . . . the common law" it must be inferred that it meant to incorporate

the established meaning. *Neder v. United States*, 527 U.S. 1, 21 (1999). At common law, "cause" means proximate cause, and there was no substantial evidence that McConville proximately caused any of Akorn's violations.

The Seventh Circuit failed to acknowledge, much less resolve these issues as required under §25.

E. The Seventh Circuit Improperly Substituted Its Own (Incorrect) Conclusion That McConville Violated Exchange Act §13(b)(5) For The Commission's Erroneous Finding On That Point.

Exchange Act §13(b)(5) provides, "No person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record or account described in paragraph (2)." "Paragraph (2)," referenced in the last clause of the statute, mandates that issuers of publicly traded securities (A) keep certain books, records and accounts, (B) devise and maintain a system of internal accounting controls meeting specified standards. 15 U.S.C. §78m(b)(2).

The Commission found that Akorn's internal controls "fell far short" of the standard required by §13(b)(2) because they did not assure "the preparation of accurate financial statements." *In re McConville*, Slip Op. at 18, App. 51a. It then held that because McConville knew of the shortcomings in Akorn's internal controls, she "knowingly failed to implement" a system meeting §13(b)(2)'s standards, thereby violating §13(b)(5). *Id.*

The Commission's finding is not supported by substantial evidence. The evidence showed Akorn devised and maintained a system of internal controls, which were implemented effectively. Only one witness, a Deloitte

Touche auditor called by the SEC, testified about Akorn's internal controls based upon actual observation and testing of those controls. He testified that Deloitte had confirmed during its audit that Akorn had a system of internal controls in place, it was functioning, and—in Deloitte's view—it was adequate.[9]

More critically, the Commission read §13(b)(5) incorrectly. Section 13(b)(5) prohibits "persons" from knowingly failing to implement whatever "system of internal accounting controls" an issuer has established;[10] it also prohibits individuals from knowingly falsifying those books, records and accounts an issuer is required to maintain. Properly construed, §13(b)(5) does not require any person to assure that an issuer comply with §13(b)(2)'s requirements.

The basic problem at Akorn was not its system of internal controls; it was with the accounting software and the personnel who were using the software to track Akorn's individual accounts receivable. The SEC held that because of this problem, Akorn violated Exchange Act §13(b)(2)(A), which requires issuers to "make and keep books, records and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." 15 U.S.C. §78m(b)(2)(A). Perhaps that was the case. But the problems with Akorn's management of its accounts receivable were *not* the *cause* of the inaccuracy the

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[9] Testimony of Mario Delgado, Tr. 805, 930-932.

[10] Presumably, issuers will establish internal controls in an attempt to comply with §13(b)(2). But §13(b)(5) is not concerned with the quality of the issuer's internal controls, it is designed to address the problem of individuals who may otherwise chose not to implement whatever system of controls the issuer may devise and maintain. Those may fall short of, barely meet, or exceed the requirements of §13(b)(2), and it would make no difference for purposes of applying §13(b)(5).

Commission found in Akorn's published financial statements; they were the *condition* that the Commission and the Seventh Circuit found Akorn's financial statements did not properly describe in accordance with GAAP.[11] Had Akorn disclosed in its 2000 Form 10-K that its accounts receivable were impaired, the financial statements would have complied with GAAP and not been misleading. The Commission found that the information Akorn needed to draw the conclusion that such a disclosure was necessary was not just available to Akorn, it was known—in fact, knowledge of that information was what led the Commission (and the Seventh Circuit) to conclude that the scienter requirement of §10(b) was satisfied in this case. *In re McConville,* Slip Op. at 15-16, App. 46a-48a; *McConville*, 465 F.3d at 788, App. 16a-17a.

For all of the above reasons, the Commission's finding that McConville violated §13(b)(5) was erroneous, and the Seventh Circuit should have set it aside pursuant to Exchange Act §25. It failed to do so.

Even though McConville brought these matters to its attention, the Seventh Circuit never discussed the proper construction of §13(b)(5) or whether there was evidence that McConville had not implemented those internal controls Akorn had "devise[d] and maintain[ed]". The court evidently recognized that the Commission's reasoning could not be

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[11] Even assuming Akorn's inadequate software and personnel were treated as an internal controls failure, it would be incorrect to conclude that McConville knowingly failed to implement a proper system of internal controls. McConville did not select the deficient computer software (Macola). Its deficiencies were recognized, and it was replaced with a new system (J.D. Edwards). There was no evidence that McConville could have caused the new system to be purchased, tested, and installed before it in fact was. Thus, even if the software is viewed as the system of internal controls, there was no evidence McConville knowingly failed to implement an adequate system.

sustained, because it did not hold, as the Commission had, that McConville violated §13(b)(5) by not implementing a system of internal controls meeting the standard prescribed by §13(b)(2). Instead, it held that the record indicated Akorn's internal controls did not meet the requirements of "Statement on Auditing Standards No. 55 ¶ 32"—a standard that is nowhere referenced in the Exchange Act or the record—and on that basis concluded that "there is substantial evidence that McConville failed to implement and maintain internal accounting controls at Akorn in violation of Section 13(b)((5)." *McConville*, 465 at 790, App. 20a-21a. In so doing, the Court not only applied §13(b)(5) incorrectly, it exceeded its proper role as a court reviewing an administrative adjudication. *See America's Community Bankers*, 200 F.3d at 835.

CONCLUSION

The Seventh Circuit recognized that this case "involves mismanagement of a corporation's financial department" and that the Commission had invoked §10(b) to redress that mismanagement. *McConville*, 465 F.3d at 782, App. 3a–4a. It should have likewise recognized and redressed the Commission's over-reaching.

Section 10(b) has only limited application to corporate mismanagement cases. *See Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477-80 (1977) ("'Congress by §10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement.'") (quoting *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971)). It is not usually implicated in cases involving estimates of what indebtedness due an issuer will be collected or at some point charged off. *See, e.g., DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990); *Shapiro v. UJB*

Fin. Corp., 964 F.2d 272, 283 (3d Cir. 1992) ("[I]t is not a violation of the securities laws to simply fail to provide adequate loan loss reserves").

The Commission's application of §10(b) to McConville should have been especially suspect. As the Seventh Circuit's opinion recounted, when Akorn's chairman became concerned about the management of Akorn's accounts receivable, Akorn's Board did what corporate boards are supposed to do: it identified the problem, devised a solution, and instructed management to implement the solution. Rightly or wrongly, Akorn's Board ascribed fault to Akorn's CEO and CFO, removed them from office, and appointed replacements. Those replacements were made responsible for correcting the observed deficiencies and, in particular, reviewing the need for charge-offs of accounts.

It fell to those successor officers to assess and report any financial consequences of the mismanagement. They may not have timely or accurately reported those consequences. If so, the securities laws might properly be applied to the people who signed, filed, and published reports that did not correctly report the impact of Akorn's mismanagement. But the application of those laws to McConville was was inconsistent with this Court's teachings and conflicts with the decisions of other circuits.

The Seventh Circuit's opinion goes beyond being unduly deferential to the SEC; it contorts both the issues and the record to support the Commission's decision.

This Court should issue its writ to resolve the circuit split and to provide Petitioner, Rita J. McConville with the full, fair, and complete review due process and Exchange Act §25 require.

Respectfully submitted,

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APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 05-3510

[Filed January 17, 2007]

RITA J. MCCONVILLE, Petitioner,	)
v.	)
UNITED STATES SECURITIES AND EXCHANGE COMMISSION, Respondent.	)

Petition for Review of an Order of the Securities and Exchange Commission. No. 3-11330.

Before Hon. WILLIAM J. BAUER, Circuit Judge, Hon. KENNETH F. RIPPLE, Circuit Judge, Hon. ANN CLAIRE WILLIAMS, Circuit Judge.

ORDER

On November 27, 2006, McConville filed a petition for rehearing en banc. On consideration of the petition for rehearing, the slip opinion issued in the above-entitled cause on October 11, 2006 is hereby amended as follows. On page

11, the following footnote is added to the paragraph that currently ends with "*Id.* at 142.":

> McConville is not being found liable under an aiding and abetting theory of liability. It should be noted, however, that the Securities Exchange Act provides that in certain actions brought by the SEC, liability attaches to "any person that knowingly provides substantial assistance to another" in violation of the statute. *See* 15 U.S.C. § 78t(e). Congress enacted this provision subsequent to the Supreme Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, which holds that there is no aiding and abetting liability in private actions under § 10(b) and Rule 10b-5. *See* 511 U.S. 164, 191, 114 S. Ct. 1439, 128 L. Ed. 2d 119 (1994).

In all other respects, the members of the original panel have voted to DENY the petition for rehearing. No judge in regular active service requested a vote on the petition for rehearing en banc.

Accordingly, the petition for rehearing is DENIED.

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 05-3510

[Filed October 11, 2006]

RITA J. MCCONVILLE, Petitioner,	)
v.	)
UNITED STATES SECURITIES AND EXCHANGE COMMISSION, Respondent.	)

Before BAUER, RIPPLE, and WILLIAMS, Circuit Judges.

OPINION

WILLIAMS, *Circuit Judge*. "'There cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy.'" *Basic Inc. v. Levinson*, 485 U.S. 224, 230, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988) (quoting H.R. Rep. No. 1383, 73d Cong., 2d Sess., 11 (1934)). This case involves mismanagement of a corporation's financial department that eventually caused it to report its financial health inaccurately. The United States Securities and Exchange Commission

("SEC" or "Commission") determined that, during her tenure as chief financial officer for Akorn Incorporated ("Akorn"), Rita McConville caused Akorn to make misleading financial statements to investors. The Commission concluded McConville's conduct violated, among other things, Sections 10(b), 13(b)(2) and 13(b)(5) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78m(b)(5), and ordered her to cease and desist from committing or causing any further violations of federal securities laws. McConville now petitions us to review the Commission's cease-and-desist order. For the reasons that follow, we deny the petition for review.

I. BACKGROUND

A. Akorn's Financial Reports and SEC Filings

Akorn is a corporation that manufactures and sells diagnostic and therapeutic pharmaceuticals. During the time relevant to this proceeding, Akorn's customers included both pharmaceutical wholesalers and direct or end-use customers. However, the company's profits were primarily from five major wholesale customers, which amounted to approximately 43% of its total sales and 60% of its gross accounts receivable as of December 31, 2000. Akorn's customers would generally order products and be invoiced according to varying rates, corporate credits, and payment schedules. Invoices were typically twenty to thirty pages long. Payment schedules varied between thirty and ninety days, with larger wholesalers generally enjoying longer payment terms than direct customers. Akorn classified its payment schedules as current, thirty to sixty days past due, sixty to ninety days past due, and over ninety days past due. Akorn, however, did not charge interest on overdue bills, thus minimizing the incentive for customers to remit payments in a timely manner. A customer payment to Akorn was accompanied by a remittance advice of

up to 400 lines in length. A remittance advice explained the payment and, in some instances, asserted claims for a variety of credits that could apply to the order.

In the late 1990's, Akorn's invoicing system was a labyrinth in which the company billed customers and processed cash remittances and credit claims against invoices at three different finance offices that used different computer programs and record-keeping mechanisms. In 1999, in an effort to centralize its finance, billing, and accounts receivable records, Akorn began using a software program called Macola. Akorn's use of Macola was short-lived, as the software proved incapable of tracking the age of Akorn's outstanding invoices, monitoring debits and credits applied to a particular customer account, and handling high-volume data management. In 2000, Akorn began using a J.D. Edwards software package. Rather than migrating its billing files from the Macola software to the J.D. Edwards software, Akorn recorded new receivables on the J.D. Edwards software, but the company did not transfer the existing Macola-tracked accounts. The result was a parallel system of bill tracking that used two different software modules.

Petitioner Rita McConville served as chief financial officer ("CFO") for Akorn from February 28, 1997 to March 20, 2001. As CFO, McConville reported to Akorn's president and chief executive officer ("CEO"), Floyd Benjamin. McConville supervised Akorn's corporate controller and its finance departments, and she worked with Akorn's auditor, Deloitte & Touche LLP ("Deloitte"). As CFO, McConville was also, along with Akorn's corporate controller, responsible for filing Akorn's financial documents with the SEC.

On February 25, 2000, Akorn's auditor, Deloitte, sent a letter to its board of directors, alerting the board to anticipated

problems in Akorn's financial statements for the fiscal year ending on December 31, 1999. The report identified as particularly problematic Akorn management's failure to review the accounts receivable in detail, misapplication of credits and payments to customer accounts, and failure to collect outstanding balances effectively and efficiently. The report also included a section entitled "Management Response," which was drafted in part by McConville, stating that management had begun an effort to reconcile all customer accounts, with a goal of "significant collection resolution by June 30, 2000 and complete cleanup by August 31, 2000."

Later in 2000, the disarray in Akorn's financial department boiled over when a billing discrepancy arose between Akorn and its largest customer, Cardinal Health Incorporated, which represented 12% of Akorn's net sales and 22% of its gross accounts receivable. Akorn's records (based on invoices going back to 1999 when the Macola software was used) showed that Cardinal owed Akorn approximately $4 million. Cardinal's records showed that it had a credit balance with Akorn of approximately $800,000, meaning the variance in the companies' books differed by nearly $5 million. The chairman of Akorn's board of directors and a major stockholder, John Kapoor, instructed McConville and the corporation's CEO to meet with Cardinal and resolve the billing dispute. McConville took copies of the largest outstanding invoices to the meeting with Cardinal, leaving behind the invoices with smaller balances.[1] During the

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[1] McConville testified that she believed she took only invoices for more than $10,000 to the meeting with Cardinal. The Commission, however, noted other evidence in the record suggesting that the invoices McConville presented at the meeting were only those with balances of more than $50,000.

meeting, McConville presented only the larger outstanding invoices to Cardinal for payment. After the meeting, Cardinal sent Akorn $913,000, which it viewed as full payment to settle any debt it owed and creating a credit balance with Akorn. Akorn, on the other hand, believed that many outstanding Cardinal invoices remained unpaid, and a March 15, 2001 letter from CEO Benjamin to Cardinal stated that there was still a discrepancy of more than $5 million to be reconciled between the Akorn records and the Cardinal records. (It is unclear from the record how the discrepancy of just under $5 million before the meeting jumped to over $5 million after the meeting).

Notwithstanding the lingering dispute between Cardinal and Akorn over the amount of Cardinal's outstanding balance, if any, McConville reassured Akorn's auditor Deloitte that the customer accounts were successfully being reconciled and that there was little past due money owing from wholesalers because most of the aging balances were offset by more recent credits.[2] McConville also wrote a press release, dated February 20, 2001, announcing an approximate $2 million profit in Akorn's fourth-quarter results. During February and early March, McConville also reviewed drafts of the 2000 financial statements.

Still not satisfied with Akorn's financial condition, Kapoor assigned McConville to work with a consultant hired by Kapoor to conduct a thorough analysis of Akorn's accounts receivable and to submit a report discussing any potential write-offs of the receivables. On March 15, 2001, the

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[2] Joint Appendix at 413, *McConville v. SEC*, No. 05-3510 (7th Cir. Nov. 17, 2005).

consultant submitted a report to Kapoor, stating, in relevant part:

> **The wholesaler accounts have never been worked.** We are talking about an accumulation of problems over a 3 or 4 year period. This provides us with a legacy of pages and pages of A/R[3] reports on each of those five accounts, consisting of a maze of transactions including: open invoices, partially paid invoices, billbacks, credits for return goods, credits for damaged goods, credits for shipments not received, credits for billing errors, rebate credits, chargeback credits, deductions taken arbitrarily by the wholesaler, situations where the wholesaler used credits multiple times, and unapplied cash. These transactions go back as far as 1996.

(Emphasis in original). The consultant further concluded that "there [we]re no quick fixes available" because "[n]o management reports exist that trend sales, cash, A/R aging, reserves, unbilled, or [days sales outstanding]. Therefore, the A/R could not have been properly monitored." At the end of the day, the consultant concluded that "a determination on the collectibility will require a substantial amount of time (months) and work." Although Kapoor instructed McConville to work with the consultant, McConville maintains that she never viewed the report or discussed its contents before it was submitted to the board of directors.

On March 20, 2001, Akorn's board of directors removed McConville from her position as CFO, and demoted her to

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[3] "A/R" in the consultant's report is shorthand for "accounts receivable."

corporate controller.[4] As part of her new duties, McConville reported to incoming CFO Kevin Harris, and she was tasked with resolving the billing dispute with Cardinal. McConville also continued her work, the degree to which is disputed by the parties, compiling the figures for Akorn's 2000 fiscal year audit for the financial statements that would be filed with the SEC. What is apparent from the record is that McConville's input in the fiscal year 2000 financial statements began while she was CFO of Akorn.[5]

As stated, during her tenure as CFO, McConville frequently reassured Akorn's auditor, Deloitte, that the books would eventually balance out. She also regularly met with Deloitte representatives and reviewed preliminary draft figures for the financial statements. According to the Commission's findings, by McConville's last day as CFO on March 20, the financial statements were largely completed, and a draft of the 2000 Form 10-K, a document reporting a corporation's financial health to the SEC, had already been prepared. The Commission also found that, as CFO, McConville reviewed a draft of the 2000 Form 10-K, the

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[4] Also on March 20, 2001, the board of directors demoted Akorn's CEO Floyd Benjamin to vice president, and Kapoor became the interim CEO.

[5] McConville concedes that she had some input in drafting the financial statements while she was CFO, but she contends that the preparation of Akorn's Form 10-K did not begin in earnest until after she was removed as CFO. McConville contends that her involvement in drafting the Form 10-K was limited to preparing a single footnote pertaining to the corporation's stock options.

filing of which was delayed due to the consultant's investigation.[6]

McConville, among others, signed two management representation letters in connection with Deloitte's annual audit of the financial statements filed with the 2000 Form 10-K. The first letter, dated February 23, 2001, stated that, to the best of McConville's knowledge: (1) other than those disclosed, no events had occurred subsequent to December 31, 2000 that required consideration as adjustments to or disclosures in the consolidated financial statements; (2) management believed the credit allowances were adequate to absorb currently estimated uncollectible receivables in the account balances; and (3) management had reviewed the financial statements for impairments of Akorn's assets, and no adjustment to the statements was required.[7] Notably, McConville admits that the task of resolving the Cardinal billing dispute was "far from complete on April 17, 2001."[8] However, the second letter she signed, dated April 17, 2001, stated that "there are no events which have occurred subsequent to February 23, 2001 that have a material effect

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[6] McConville contends that she did not see a draft of the 2000 Form 10-K during her tenure as CFO. However, the Commission deferred to the administrative law judge's finding that McConville's testimony to that effect was incredible, and that she did in fact review a draft of the Form 10-K while she was CFO. And, as we explain below, our review of the Commission's finding is highly deferential.

[7] Joint Appendix at 388-392, *McConville v. SEC*, No. 05-3510 (7th Cir. Nov. 17, 2005).

[8] Brief of Petitioner-Appellant at 19, *McConville v. SEC*, No. 05-3510 (7th Cir. Dec. 6, 2005).

on the financial statements that are in the filing or that should be disclosed in order to keep those statements from being misleading."[9] That same day, Akorn filed the 2000 Form 10-K with the SEC, reporting a net income of $2,187,000, current assets of $42,123,000 (as of December 31, 2000), and accounts receivable of $24,144,000, which amounted to approximately 57% of Akorn's then-current assets. McConville did not sign the Form 10-K.

On May 22, 2001, a month after filing the Form 10-K, Akorn filed its quarterly report, Form 10-Q, for the quarter that ended on March 31, 2001. In its Form 10-Q, Akorn increased by $7.5 million its allowance for doubtful accounts, that is accounts with balances unlikely to be recovered. McConville's employment with Akorn terminated in July 2001. Over a year later, on October 7, 2002, Akorn restated its financial statements for 2000 and 2001 by filing a Form 10-K/A. The Form 10-K/A stated that Akorn "had not adequately considered all of the information available with respect to certain disputed receivables in establishing its allowance for uncollectible accounts as of December 31, 2000," and the $7.5 million increase in its allowance for doubtful accounts should have been recorded at the end of 2000, rather than in the 2001 Form 10-Q. At the end of the day, once the financial statements were corrected, Akorn sustained a net loss of $2.4 million in 2000, rather than a gain of $2 million as it had originally reported in its Form 10-K.

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[9] Joint Appendix at 396, *McConville v. SEC*, No. 05-3510 (7th Cir. Nov. 17, 2005).

B. SEC Proceedings

On November 12, 2003, the SEC instituted proceedings against McConville and Akorn CFO Harris. The SEC alleged that, as CFO, and later as corporate controller, McConville's mismanagement of Akorn's financial department caused the corporation to file inaccurate financial statements with the Commission in violation of federal securities laws. An administrative law judge ("ALJ") determined that McConville and Harris were liable, and the ALJ ordered McConville to cease and desist and to disgorge nine months of her Akorn salary. On review, the Commission largely agreed with the ALJ's decision, finding the footnotes to the Form 10-K should have reported an unquantifiable impairment in Akorn's accounts receivable and that McConville lied to Deloitte about the financial health of the company, which she failed to monitor properly. The SEC concluded that McConville's conduct violated Sections 10(b), 13(b)(2) and 13(b)(5) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78m(b)(5), as well as SEC Rules 13b2-1 and 13b2-2. And, although the Commission believed disgorgement was unwarranted, it ordered McConville to cease and desist from further securities violations. This petition for review followed.

II. ANALYSIS

The Securities Exchange Act of 1934, 15 U.S.C. § 78y (2000), requires us to give highly deferential, conclusive effect to the Commission's factual findings, so long as they are supported by substantial evidence in the record. *Monetta Fin. Servs., Inc. v. SEC*, 390 F.3d 952, 955 (7th Cir. 2004). As a congressionally authorized administrative agency, the Commission's interpretation of the Securities Exchange Act will be upheld, unless the interpretation is contrary to clear

congressional intent. *United States v. Mead Corp.*, 533 U.S. 218, 227, 121 S. Ct. 2164, 150 L. Ed. 2d 292 (2001); *see also Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837, 843-45, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984). In addition, the Commission's interpretation of its own regulations promulgated pursuant to the Act will be upheld, unless the regulations are arbitrary, capricious, or manifestly contrary to the statute. *Chevron*, 467 U.S. at 844.

A. There is Substantial Evidence that McConville Violated SEC Rule 10b-5.

Under Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 77j(b), promulgated as Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5, the Commission must show that McConville (1) made a false statement or omission (2) of material fact (3) with scienter (4) in connection with the purchase or sale of securities. *SEC v. Maio*, 51 F.3d 623, 630 (7th Cir. 1995).

As an initial matter, we briefly address McConville's argument that she cannot be primarily liable for the misstatements in Akorn's 10-K because her significant participation in creating the corporate misstatements cannot form the basis for Rule 10b-5 liability.[10] McConville's argument is essentially that despite her substantial involvement in drafting the financial statements, their subsequent fraud on the market cannot be attributed to her because she did not sign or physically file the Form 10-K. This circuit long ago rejected McConville's literal interpretation of Rule 10b-5's antifraud provision. *See SEC v.*

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[10] Brief of Petitioner-Appellant at 34, *McConville v. SEC*, No. 05-3510 (7th Cir. Dec. 6, 2005).

Holschuh, 694 F.2d 130, 142 (7th Cir. 1982). In *Holschuh*, a corporate officer provided materially misleading information that was ultimately incorporated into offering circulars given to potential investors. The officer argued that Rule 10b-5 liability could not be imposed against him because he had no direct contact with investors or editorial control over the contents of the offering circulars. We disagreed, holding that "actual or first-hand contact with offerees or buyers [is not] a condition precedent to primary liability for antifraud violations," so long as the requisite intent was established. *Id.* at 142.

As to the merits of the case against McConville, the SEC concluded the following:

> The violations here were significant. McConville was responsible for misrepresentations and omissions in Akorn's Form 10-K, which was filed with the Commission and thus made available to investors. As a result of the deficiencies in Akorn's recordkeeping and internal controls, Akorn's receivables were overstated, no impairment of the receivables was disclosed, and no reserve was created for customer accounts that represented 60% of the receivables. McConville made misrepresentations to Deloitte in the management representation letters to Deloitte, knowing that Deloitte would be basing assumptions on those letters in its work on the 2000 audit.[11]

We now consider whether there is substantial evidence to support the Commission's finding that, with the requisite

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[11] *In re Rita v. McConville*, Exchange Act Release No. 51950, 2005 WL1560276 at *15 (June 30, 2005).

scienter, McConville breached a duty to disclose an unquantifiable impairment in Akorn's accounts receivable. Given that the loss to Akorn's investors was inevitable when the Form 10-K was filed, and only the magnitude of the loss was uncertain, as discussed below, we conclude McConville's failure to disclose the impairment in Akorn's financial statements violated Rule 10b-5.

McConville argues that the Commission's findings regarding the first and third elements of Rule 10b-5 liability are not supported by substantial evidence. Regarding the first factor (whether she made or, more precisely, caused Akorn to make material misstatements to investors), McConville argues that the SEC's findings are not supported by substantial evidence because she had no obligation to file or cause the Form 10-K to be filed.[12] This argument misses the point, however. As we have stated, the issue is not whether McConville (quite literally) delivered the misleading statements to the SEC, but whether she caused Akorn to make material misstatements to the investing public. Importantly, McConville does not dispute three critical facts that are fatal to her argument: (1) she drafted and reviewed the core financial statements that overestimated Akorn's profits; (2) in February 2001, she reviewed and approved a draft of the Form 10-K that consisted of the inaccurate core financial statements;[13] and (3) in a February 23, 2001 letter to Deloitte,

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[12] Brief of Petitioner-Appellant at 30, *McConville v. SEC*, No. 05-3510 (7th Cir. Dec. 6, 2005).

[13] Notably, the Commission found that the Form 10-K that was ultimately filed with the SEC was virtually identical to the draft McConville reviewed while still CFO of Akorn. Brief of Petitioner-Appellant, appendix at 14, *McConville v. SEC*, No. 05-3510 (7th Cir. Dec. 6, 2005).

McConville represented that management had reviewed the financial statements for impairments of Akorn's assets, and that no adjustment to the statements was required. McConville also attempts to wash her hands of the misstatements, arguing her involvement with Akorn's financial statements ceased after she prepared the February 20, 2001 press release announcing Akorn's 2000 earnings were approximately $2 million. Here again, the record belies McConville's argument. In Akorn's April 17, 2001 letter to Deloitte, McConville represented that there were no events to occur subsequent to February 23, 2001 that materially affected the financial statements that were in the Form 10-K filing or that should be disclosed in order to keep those statements from being misleading. Thus, the same day the SEC filing was disseminated to investors, McConville represented to Akorn's auditor that the financial statements that she compiled were accurate. Therefore, we conclude that her substantial involvement in compiling the misleading statements and her reassuring Akorn's auditors as to their accuracy is substantial evidence to establish that McConville made a false statement or omission.

As to the third element (whether McConville acted with scienter), we also conclude that the Commission's finding was supported by substantial evidence. The requisite scienter is "an extreme departure from the standards of ordinary care, [] which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 600 (7th Cir. 2006) (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)).

McConville's conduct was an extreme departure from the requisite standard of ordinary care because she was well

aware that Akorn's financial department was in critical disarray, and she failed to disclose inevitable problems in the financial statements. In light of Deloitte's February 25, 2000 letter raising concerns about mismanagement of the department, McConville responded that management had begun an effort to reconcile all customer accounts, with a goal of "significant collection resolution by June 30, 2000 and complete cleanup by August 31, 2000." That goal was never met. McConville was also aware that there was an ongoing $5 million dispute between Akorn and its biggest customer, Cardinal. Most importantly, McConville knew that resolving the Cardinal billing dispute was "far from complete on April 17, 2001."[14] Yet, the very day when the Form 10-K was filed, she nonetheless represented to Akorn's auditors that "there are no events which have occurred subsequent to February 23, 2001 that have a material effect on the financial statements that are in the filing or that should be disclosed in order to keep those statements from being misleading."[15] Thus, there is substantial evidence in the record to support the Commission's finding that McConville's conduct (at least) occurred with recklessness. *Makor*, 437 F.3d at 600; Sundstrand, 553 F.2d at 1045.[16]

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[14] Brief of Petitioner-Appellant at 19, *McConville v. SEC*, No. 05-3510 (7th Cir. Dec. 6, 2005).

[15] Joint Appendix at 396, *McConville v. SEC*, No. 05-3510 (7th Cir. Nov. 17, 2005).

[16] For reasons similar to why we conclude there is substantial evidence to support the Commission's finding that McConville violated Rule 10b-5, we conclude there is substantial evidence to support its finding that she violated Section 13(a) of the Act and SEC Rules 13a-1 and 12b-20.

B. There is Substantial Evidence that McConville Violated SEC Rules 13b2-1 and 13b2-2.

McConville also challenges the Commission's finding that she violated SEC Rules 13b2-1 and 13b2-2. Both of these findings are supported by substantial evidence, however. Rule 13b2-1 provides: "No person shall directly or indirectly, falsify or cause to be falsified, any book, record or account subject to Section 13(b)(2)(A) of the Securities Exchange Act." 17 C.F.R. § 240.13b2-1 (2006). In its opinion, the SEC found that "Akorn's accounts receivable did not accurately show what invoices had been paid or what amounts were still owing on particular invoices and therefore did not accurately and fairly reflect the transactions and dispositions of Akorn's assets."

McConville argues that there is no evidence of her scienter to violate Rule 13b2-1. However, the Commission has previously stated that there is no scienter requirement in SEC Rule 13b2-1 because § 13(b) of the 1934 Securities Exchange Act "contains no words indicating that Congress intended to impose a 'scienter' requirement." Promotion of the Reliability of Financial Information and Prevention of the Concealment of Questionable or Illegal Corporate Payments and Practices, Exchange Act Release No. 34,15570, 1 6 SEC Docket 1143, 1151 (February 15,1979). As we have stated, the Commission's interpretations of its own regulations are entitled to deference as long as, as in this case, the interpretation is not arbitrary, capricious, or manifestly contrary to the statute. *See, e.g., Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837, 842-43, 81 L. Ed. 2d 694 (1984) (courts must give deference to administering agency's reasonable statutory interpretations). Because scienter is not required under the Rule, and because there is otherwise substantial evidence of liability in the record, we will not

reverse the SEC's finding that McConville violated Rule 13b2-1.

The Commission's finding that McConville violated Rule 13b2-2 is also supported by substantial evidence. Rule 13b2-2 provides: "No director or officer of an issuer shall, directly or indirectly: (1) make or cause to be made a materially false or misleading statement to an accountant in connection with . . . (i) [a]ny audit, review or examination of the financial statements of the issuer. . . ." 17 C.F.R. § 240.13b2-2. For the reasons already explained in our discussion of her Rule 10b-5 argument, we reject McConville's argument that there is not substantial evidence supporting the Commission's conclusion that she lied to Deloitte in the two management representation letters she signed. Particularly, McConville knew the Cardinal dispute over $5 million was unresolved when she signed the representation letters, reassuring Deloitte that the financial statements were accurate.

C. *There is Substantial Evidence that McConville Violated Sections 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the 1934 Securities Exchange Act.*

Section 13(b)(2)(A) of the Securities Exchange Act requires an issuer of registered securities to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer. . . ." The Commission concluded that as CFO, McConville caused Akorn to violate Section 13(b)(2)(A) of the Act. McConville now argues that she cannot be liable for causing the Section 13(b)(2)(A) violation "because the Commission cannot identify any evidence suggesting she was responsible for the maintenance and

upkeep of Akorn's books and records."[17] This argument is without merit. As chief financial officer, McConville's very job at Akorn was to manage its financial department and ensure its records and accounts were accurately and fairly maintained, and there is substantial evidence that she failed to do so. The record indicates that Akorn's financial records were in an ongoing state of disarray. By spring 2001, the wholesaler accounts (which were the bulk of Akorn's sales) had never been reconciled; and there was an accumulation of problems over a three or four year period. Even McConville admits that the reconciliation process in Akorn's financial department was continuing when her employment terminated in July 2001.[18] We affirm the SEC's conclusion that she caused Akorn to violate Section 13(b)(2)(A) of the Act.

McConville also challenges the Commission's conclusions that she violated Sections 13(b)(5) and 13(b)(2)(B) of the Act, which require corporations to implement and maintain internal accounting controls. Examples of internal controls include manual or automated review of records to check for completeness, accuracy and authenticity; a method to record transactions completely and accurately; and reconciliation of accounting entries to detect errors.[19] For reasons similar to

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[17] Brief of Petitioner-Appellant at 45, *McConville v. SEC*, No. 05-3510 (7th Cir. Dec. 6, 2005).

[18] Brief of Petitioner-Appellant at 19, *McConville v. SEC*, No. 05-3510 (7th Cir. Dec. 6, 2005).

[19] *See In re Albert Glenn Yesner, CPA*, Initial Decision, Exchange Act Release No. 184, 2001 WL 587789 at *33 (May 22, 2001) (citing STATEMENT ON AUDITING STANDARDS No. 55 P 32, CONSIDERATION OF INTERNAL CONTROL IN A FINANCIAL STATEMENT AUDIT (1998). VINCENT M.

why we affirm the Commission's Section 13(b)(2)(A) finding, we likewise conclude there is substantial evidence that McConville failed to implementand maintain internal accounting controls at Akorn in violation of Section 13(b)(5).

III. CONCLUSION

Accordingly, for the reasons set forth in this opinion, the petition for review is DENIED.

O'REILLY ET AL., MONTGOMERY'S AUDITING 9-7 through 9-10, 9-13 through 9-14 (12th ed. 1988)).

UNITED STATES COURT OF APPEALS
For The Seventh Circuit
Chicago, Illinois 60605

No. 05-3510

[Filed October 11, 2006]

RITA J. MCCONVILLE,	)
Petitioner	)
	)
v.	)
	)
SECURITIES AND EXCHANGE COMMISSION,	)
Respondent	)
	)

Petition for Review of an order of the Securities & Exchange Commission
No. 3-11330

BEFORE:
Honorable WILLIAM J. BAUER, Circuit Judge
Honorable KENNETH F. RIPPLE, Circuit Judge
Honorable ANN CLAIRE WILLIAMS, Circuit Judge

Agency Judgment
With Oral Argument

IT IS ORDERED AND ADJUDGED by this court that the petition for review is DENIED, with costs in accordance with the decision of this court entered this date.

APPENDIX C

Securities Exchange Act of 1934
Accounting and Auditing Enforcement Act

Administrative Proceeding File No. 3-11330

Release No. 51950, Release No. 34-51950,
Release No. AE - 2271,
2005 WL 1560276 (S.E.C. Release No.)

[Filed June 30, 2005]

IN THE MATTER OF)
RITA J. MCCONVILLE)
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OPINION OF THE COMMISSION

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Antifraud and reporting violations

Corporate officer, who served as chief financial officer and then corporate controller, falsely represented to auditors that corporation's consolidated financial statements were in conformity with generally accepted accounting principles and that no events had occurred within stated period that had a material effect on financial statements or should have been disclosed in order to keep statements from being misleading;

made misleading statements and omitted to state facts that would make representations in corporation's annual report not misleading; and failed to see that corporation implemented adequate internal controls, resulting in inaccuracies in corporation's books, records, and accounts, thereby violating and causing the corporation to violate antifraud and reporting provisions of the federal securities laws and rules thereunder. Held, it is in the public interest for respondent to be ordered to cease and desist from committing or causing further antifraud and reporting violations.

APPEARANCES:

Kenton E. Knickmeyer and John S. Kingston, of Thompson Coburn LLP, for Rita J. McConville.

Polly A. Atkinson and Elizabeth E. Krupa, for the Division of Enforcement.

Appeal filed: October 19, 2004
Last brief received: January 18, 2005
Oral argument: May 23, 2005[1]

I.

Rita J. McConville appeals from the decision of an administrative law judge. The law judge found that McConville had significant responsibility for the financial statements in the Form 10-K for the year ended December 31,

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[1] Rule of Practice 451(d), 17 C.F.R. § 201.451(d), provides that a member of the Commission who does not attend an oral argument may participate in the decision of the proceeding if that member reviews the oral argument transcript. Commissioner Glassman, who did not attend the oral argument in this matter, has performed the requisite review.

2000 (the "2000 Form 10-K") filed by her employer, Akorn, Inc. ("Akorn" or "the Company"), which materially inflated Akorn's accounts receivable, net sales, and assets; caused Akorn to maintain inaccurate books and records; and falsely assured Akorn's auditors that the financial statements in the 2000 Form 10-K complied with Generally Accepted Accounting Principles ("GAAP") and that she did not know of any events that would materially impact those financial statements.[2] In so doing, the law judge found, McConville violated Sections 10(b) and 13(b)(5) of the Securities Exchange Act of 1934[3] and Rules 10b-5, 13b2-1 and 13b2-2 thereunder,[4] and caused Akorn to violate Sections 13(a) and 13(b)(2) of the Exchange Act and Rules 12b-20 and 13a-1 thereunder.[5] The law judge ordered McConville to cease and desist from violating and causing violations of these provisions, and to pay disgorgement in the amount of $115,858, plus prejudgment interest. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

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[2] The Financial Accounting Standards Board promulgates GAAP, which are the "conventions, rules, and procedures that define accepted accounting practice." Barron's Dictionary of Finance and Investment Terms 234-35 (5th ed. 1998). Regulation S-X, 17 C.F.R. § 210.1-02(d), requires that the financial statements of a public corporation must be audited by an accountant in accordance with generally accepted auditing standards. *United States v. Arthur Young & Co.*, 465 U.S. 805, 811 n.6 (1984).

[3] 15 U.S.C. §§ 78j(b), 78m(b)(5)

[4] 17 C.F.R. §§ 240.10b-5, 240.13b2-1, 240.13b2-2.

[5] 15 U.S.C. §§ 78m(a), 78m(b)(2); 17 C.F.R. §§ 240.12b-20, 240.13a-1.

II.

Background

McConville served as chief financial officer ("CFO") of Akorn from February 28, 1997 until March 20, 2001, when she was succeeded by Kevin M. Harris.[6] From March 21 to July, 2001, McConville was employed by Akorn as corporate controller. During most of the time in question, McConville reported to Floyd Benjamin, Akorn's president and chief executive officer ("CEO"). As CFO, McConville supervised Akorn's corporate controller and its finance department, and was responsible for working with Deloitte & Touche LLP ("Deloitte"), Akorn's auditors. As CFO, McConville, together with Akorn's controller, Thomas Costello, was responsible for Akorn's filings with the Commission. In its 2000 Form 10-K, filed with the Commission pursuant to Section 13(a) of the Exchange Act,[7] Akorn reported net income of $2,187,000 in 2000. Akorn reported current assets of $42,123,000 as of December 31, 2000, and accounts receivable of $24,144,000, which amounted to approximately 57% of Akorn's current assets.

At all relevant times, Akorn was a corporation that, among other things, manufactured and sold diagnostic and therapeutic pharmaceuticals. Although Akorn's customers

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[6] Harris was a respondent in this proceeding. The law judge found that he willfully violated Rule 13b2-2 and that he willfully aided and abetted and caused Akorn's violations of Exchange Act Section 13(a) and Rules 13a-1, 13a-13, and 12b-20. She declined to impose sanctions on Harris. *Rita J. McConville*, Initial Decision Rel. No. 259 (Sept. 27, 2004), 83 SEC Docket 3325, 3364-73.

[7] 15 U.S.C. § 78m.

included both pharmaceutical wholesalers and direct or end-use customers, a large portion of its sales were made to wholesale distributors. In 2000, Akorn's sales to five such distributors (the "top five wholesale customers") accounted for 43% of its total sales in 2000 and approximately 60% of its gross accounts receivable as of December 31, 2000.

Akorn's Problems With Tracking Customer Account Status

Both Akorn's computer system and some of its business practices made keeping track of its customer accounts problematic. When McConville arrived at Akorn in 1997, the company billed customers and processed cash remittances and credit claims against invoices at three different finance offices, each of which used a different accounting software system. By late 1999, however, Akorn had centralized its finance, billing, and accounts receivable records on a software program called Macola. Later, primarily during 2000, Akorn shifted many of its records, at all of its locations, onto a J.D. Edwards software package, which allowed more sophisticated information recording. In connection with this transition, Akorn recorded new receivables on the J.D. Edwards software, but did not transfer existing accounts receivable due to concerns that conversion might not preserve the integrity of the data.

Akorn's terms of sale varied among customers, with payment schedules of between 30 and 90 days. Wholesalers generally enjoyed longer payment terms than direct customers. Akorn did not charge interest on overdue bills. Akorn classified its aging reports as current, 30-60 days past due, 60-90 days past due, and over 90 days past due.

Extensive paperwork was involved in keeping track of customer orders and payments. With each shipment to a

wholesaler, Akorn issued and sent an invoice. A 25- or 30-page invoice was not uncommon. A customer payment to Akorn was accompanied by a remittance advice of up to 400 lines in length, which explained the payment and asserted claims, where applicable, to a variety of credits.[8] Akorn was unable to match customer payments or credits to invoice numbers, so it could not post a receipt against a particular invoice.[9]

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[8] Kevin Harris, who succeeded McConville as CFO, testified that a 22-page remittance advice would be considered short. The credits, which were available under various terms with varying deadlines, included chargebacks, or credits for the difference between the list price wholesalers were billed for products and the contract price to certain end users who had special contractual arrangements with Akorn, as well as various rebates.

[9] McConville testified that chargebacks, for example, were dentified by product batch number, not invoice number, and that the same batch number could appear on 150 or more invoices. Thus, matching a chargeback to an invoice was impossible. Customers did not always use the same numbers Akorn used, which created further problems.

Mario Delgado, a Deloitte auditor involved with Akorn's fiscal year 2000 audit, testified that the Macola system "didn't link together a debit with a credit that may have subsequently been issued or a payment that may have been subsequently received." Delgado explained:

> Typically ... you would want to link all that together and ... simply understand what is this customer still owing. So I invoice them $100 and subsequently issued a credit for $10 and a subsequent payment of $90, what you really are

Using the Macola software to review the aging of accounts receivable presented particular difficulties.[10] In Macola as used at Akorn, the age of receivables was determined from when the invoices were issued. The Macola software also kept track of payments, credits, and rebates, based on when they were applied to the account. Akorn used the term "aging" indiscriminately to apply to receivables, payments, credits, and rebates, categorizing them in "buckets" or brackets to indicate how recently the invoice had been issued or the payment, credit, or rebate had been applied. Thus, related items (original invoice, payment, and credit) often appeared in different aging "buckets" depending on the dates of the transactions.[11] An "aging" report for a single customer,

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concerned about is they owe zero. ... Most companies do link those three together and just ... wouldn't show anything for that customer because it's paid off.

[10] Although Akorn did not charge interest on overdue bills, the age of receivables was nonetheless important because, as testified by Jack Maire, a consultant brought in to analyze Akorn's receivables, the older a receivable is, the more difficult it becomes to collect it. Moreover, the passage of time sometimes made it difficult for Akorn to produce documentation to prove what it was owed. Nancy Phillips, Akorn's assistant controller from March 1999 to September 2001, testified that proofs of delivery were often unobtainable after nine months to a year and that Akorn "pretty often" lacked documentation to support its assertion of amounts due. Phillips also testified that in her experience, wholesalers in some instances purposely waited to pay until the nine months or year had passed so that proofs of delivery would be unobtainable.

[11] As Delgado explained: "[A]n invoice would typically be issued first and would age based on the invoice date. Subsequent to that a credit might be issued, say, a month later. And subsequent to that a payment might be received, let's say, a month after that. In

showing all transactions with that customer, by date, could have as many as 4000 lines. Additionally, the Macola system was incapable of handling certain tasks that involved a high volume of transactions without ceasing to function. Thus, a detailed review of the age of accounts receivable in Macola was virtually impossible.[12]

McConville's Awareness Of And Attempts to Address Problems With Tracking Customer Accounts

On February 25, 2000, Deloitte sent a letter to Akorn's board of directors, to which it attached a report prepared in connection with Deloitte's audit of Akorn's financial statements for the year ended December 31, 1999. The report commented on, among other things, Akorn's internal controls. Under the heading "Accounts Receivable," the report noted management's failure to review the accounts receivable in detail, misapplication of credits and payments to customer accounts, and failure to collect on outstanding balances effectively and efficiently. Deloitte recommended reconciling customer accounts with the customers, starting with the wholesaler accounts. The corresponding section of the report captioned "Management Response," which was drafted in part by McConville, stated that management had begun an effort to reconcile all customer accounts and pursue payment of aged balances, with a goal of "significant

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that scenario the invoice would age one month before the credit which would age one month before the payment. And so you could find yourself in a situation where you could have an invoice ... in one aging bucket, a credit issued in a subsequent bucket, and a payment issued in a third more recent bucket."

[12] Akorn generated some summary aging reports, but Delgado testified that the reports had "little or no value."

collection resolution by June 30, 2000 and complete cleanup by August 31, 2000." This management goal was not met.

Concerns were also expressed at both board and audit committee meetings that as Akorn's sales were growing, more and more receivables were moving into the older aging "buckets," i.e., were remaining uncollected for longer times. At McConville's request, Akorn's controller and its accounts receivable manager analyzed the available data and posited that a major factor for the increase in aging was the increase in percentage of sales to wholesalers, who were allowed more time to pay than Akorn's direct customers. Nonetheless, the aging of receivables remained a management and audit committee concern.

During 2000, Akorn realized approximately 12% of its net sales from Cardinal Health, Inc. ("Cardinal"), and Cardinal's accounts receivable balance represented approximately 22% of gross accounts receivable. This made Cardinal both Akorn's largest customer and the customer with the largest accounts receivable balance. In the fourth quarter of 2000, John Kapoor, chairman of the board of Akorn and a major stockholder, instructed McConville and Benjamin to meet with Cardinal and try to collect some of the money Cardinal owed to Akorn. In February, 2001, when the meeting took place, Akorn's records showed that Cardinal owed it approximately $4 million, based on invoices going back at least as far as 1999. Cardinal's own records showed that the balance was approximately $800,000 in Cardinal's favor, yielding a discrepancy of nearly $5 million.[13] McConville

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[13] Witnesses explained the discrepancy as due in part to Akorn's practice of booking a receivable as soon as the invoice was issued, while Cardinal forwarded the invoices it received to its

took with her to the meeting copies of open invoices from various dates, selecting the invoices involving the largest dollar amounts so that resolution would yield the biggest results.[14] After the meeting, Cardinal sent Akorn a check for approximately $913,000, which it viewed as resolving all open issues from the meeting.[15] Cardinal informed Akorn that, having sent the $913,000 check, it regarded itself as in a credit position vis-a-vis Akorn.

Although Cardinal thought the issues raised by the meeting had been resolved, Akorn believed that many issues were still outstanding. A March 15, 2001 letter from Benjamin to Cardinal stated that there was still a discrepancy of more than $5 million to be reconciled between the Akorn records and the Cardinal records, opining that the $913,000 check represented only resolution of certain individual open

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distribution centers for verification before submitting them for processing, thus occasioning some delay. Moreover, Cardinal did not record the invoice as a payable until it was due, as much as 90 days later. Additionally, McConville testified that some of the invoices shown on Akorn's records did not appear on Cardinal's records.

[14] McConville testified that she believed she took only invoices for more than $10,000. Other evidence suggests that the invoices were for more than $50,000.

[15] In an e-mail following up on the meeting, Cardinal stated that it had been unable to research some of the 1999 invoices, but that those "accounted for immaterial amounts relative to the other invoices."

invoices and there were still smaller open invoices to reconcile, as well as issues involving rebates.[16]

Despite the uncertainty of the situation, McConville told Deloitte that Cardinal had agreed to send Akorn a $913,000 check, and that indications were positive in terms of receivables.[17] McConville also told Deloitte that there was little past due money owing from wholesalers because most of the old bills were offset by more recent credits.

At around the time of McConville's and Benjamin's meeting with Cardinal, Kapoor received a telephone call from The Northern Trust Company ("Northern Trust"), with which Akorn had a banking relationship, raising questions about Akorn's financial condition and requesting that Kapoor make an additional equity investment in Akorn of $3 million.[18] Kapoor promptly arranged to meet with Akorn management and its board of directors. In a memorandum dated March 7, 2001, Kapoor assigned McConville and Harris to work with Jack Maire, a consultant brought in by Kapoor, on a thorough analysis of Akorn's accounts receivable and to submit a report

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[16] Although it is unclear from the record that McConville saw Benjamin's March 15 letter, she clearly knew that there was a $5 million discrepancy between Akorn's and Cardinal's accounting prior to the payment of the $913,000 check.

[17] The record is unclear as to when McConville told Deloitte about the $913,000 check. Delgado testified that he received assurances "throughout our audit [that] things were positive and the conversations indicated that collections were reasonable."

[18] It is unclear from the record whether Akorn had defaulted on an existing loan or whether the bank insisted on the additional investment as a condition of extending or renewing a line of credit.

discussing any potential write-offs of the receivables by the end of March.

The Maire Report

By mid-March, 2001, Maire concluded that Akorn's need for a quick infusion of cash could not be satisfied by collecting past due receivables. In a draft memorandum to Kapoor, Maire concluded that **"there are no quick fixes available"** (emphasis in original).[19] Maire indicated that, due to the scope and complexity of the receivables problem, he was unable at that time to provide an assessment of what was collectible and what the magnitude of write-offs might be. He concluded that "a determination on the collectibility will require a substantial amount of time (months) and work."

Maire recognized that, because Akorn's accounts receivable were concentrated among its top five wholesale customers, it might appear "that it should be relatively easy to collect on those five accounts and achieve the quick infusion of cash that we are looking for." His analysis, however, revealed that this was not the case:

> **[T]he wholesaler accounts have never been worked.** We are talking about an accumulation of problems over a 3 or 4 year period. This provides us with a legacy of pages and pages of A/R reports on each of those five accounts, consisting of a maze of transactions including: open invoices, partially paid invoices, billbacks, credits for return goods, credits for damaged goods, credits for shipments not

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[19] McConville testified that she did not see the memorandum while employed at Akorn.

received, credits for billing errors, rebate credits, chargeback credits, deductions taken arbitrarily by the wholesaler, situations where the wholesaler used credits multiple times, and unapplied cash. These transactions go back as far as 1996. (Emphasis in original). In Maire's view, the failure to have systematically reconciled the accounts receivable "magnifies the task to an incredibly detailed undertaking."[20] He identified "a wide array of process and system issues that severely complicate matters," including the following:

- The Macola system and the J.D. Edwards system operated simultaneously, with the pre-2001 accounts receivable on Macola. "This duplicates work and complicates matters considerably."

- "No management reports exist that trend sales, cash, A/R aging, reserves, unbilled, or [days sales outstanding]. Therefore, the A/R could not have been properly monitored."

- "A/R aging reports have not been previously printed. The staff has had no way to set collection priorities. Producing a simple aging report in descending dollar sequence proved to be a week-long task to accomplish, and then only with outside consulting help because no one within the building knew how to do it."

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[20] Maire thought that Akorn staff did not have sufficient skills and experience to handle the work.

- "Daily reports need to be published to monitor all facets affecting receivables, including unbilled, chargebacks processing backlogs, cash posting backlogs, and returns good credit processing. If any one of these is failing to be processed timely, the customer will not pay. The wholesaler will go ahead and take a deduction in the absence of a timely credit due him, which only complicates the maze of transactions already on the A/R."

Maire also noted, among other matters, problems with staffing, and stated that "[c]hargebacks may be a problem area."

On March 20, 2001, the board voted to dismiss Benjamin as CEO, making him a vice president of Akorn, and to dismiss McConville as CFO. Kapoor became interim CEO, and Kevin Harris, who had been asked by Kapoor to help address Akorn's financial situation following the telephone call from Northern Trust, was appointed interim CFO. McConville was initially asked to work under Harris's direction on various projects, but shortly thereafter Harris asked her to work with him, Maire, and several other Akorn employees on reconciling the Cardinal account. As of the end of April, 2001, McConville had identified Cardinal receivables totaling nearly $1.5 million from Akorn's aging report that were not included in a report showing amounts due and payable that she had obtained from Cardinal.

McConville's Involvement With The Fiscal Year 2000 Audit

While McConville was working on reconciling the Cardinal account, Deloitte was proceeding with work on its audit of Akorn for the year ended December 31, 2000. As noted above, McConville's responsibilities as CFO had

included working with Deloitte auditors as Deloitte performed Akorn's annual audits and quarterly reviews. McConville attended meetings with Deloitte before Deloitte began its field work; at these meetings, Deloitte reviewed the proposed scope of the audit and projected time frames. During the course of the field work, which Deloitte completed on February 23, 2001, McConville was generally available for discussions with Deloitte. She attended the meetings at the end of the field work at which Deloitte discussed its findings. She also attended audit committee meetings, which were held at the end of each quarter.

McConville had begun preparation of Akorn's 2000 Form 10-K while serving as CFO. She wrote a press release, dated February 20, 2001, that announced Akorn's fourth-quarter results and provided year-end net income and sales figures. During February and early March, she reviewed drafts of the 2000 financial statements.[21] The financial statements included

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[21] McConville admitted in investigative testimony that she reviewed a draft of the 2000 Form 10-K as CFO. Additionally, McConville's expert witness testified that McConville "performed her normal procedures as a reviewer of the draft financial statements in February" and that "she had seen drafts of the financial statements prior to her demotion" (from the position of CFO). Although McConville testified at the hearing that she no longer believed that she had reviewed a draft of the financial statements, the record supports the conclusion that she did review a draft. Moreover, the law judge, who had a chance to observe McConville's demeanor at the hearing, cited her denial that she reviewed the Form 10-K as one of a number of instances where McConville was not credible. The credibility determination of an initial fact finder is entitled to considerable weight and deference because it is based on hearing the witnesses' testimony and observing their demeanor. *See, e.g., Daniel Joseph Alderman*, 52

the numbers for year-end 2000 from the February 20 press release that McConville had authored. By March 20, McConville's last day as CFO, the financial statements to be included in the Form 10-K were largely completed,[22] and a draft of the Form 10-K had already been prepared. The filing of the Form 10-K was delayed, however, while Akorn sought to resolve the questions raised by The Northern Trust Company.

On approximately April 17, 2001, McConville was asked to sign, and did sign, two management representation letters, as corporate controller, in connection with Deloitte's annual

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S.E.C. 366, 368 (1995), *aff'd*, 104 F.3d 285 (9th Cir. 1997); *Jonathan Garrett Ornstein*, 51 S.E.C. 135, 137 (1992).

McConville contends that the law judge's determination that she reviewed a draft of the Form 10-K is clearly erroneous "because it has no basis in evidence and is the product of an impermissible inference drawn from Kevin Harris' Answer to the [Order Instituting Proceedings ("OIP)]." This characterization of the law judge's finding is inaccurate. In concluding that McConville reviewed a draft of the Form 10-K, the law judge cited, quoted from, and discussed both McConville's investigative testimony that she believed she had reviewed a draft of the Form 10-K and the testimony of McConville's expert witness, as noted above. The law judge's reference to Harris's Answer was not in connection with her finding that McConville reviewed a draft of the Form 10-K, but rather in connection with her finding that McConville had significant responsibility for it. Based on our de novo review of material in the record other than Harris's Answer, and including the law judge's credibility determination, we find that McConville reviewed a draft of the Form 10-K.

[22] Disclosures regarding Akorn's relationship with The Northern Trust Company were subsequently added.

audit of the financial statements filed with the 2000 Form 10-K. The first letter, dated February 23, 2001, stated that it was provided in connection with Deloitte's audit of Akorn's consolidated balance sheets as of December 31, 2000 and 1999, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2000. The letter represented that, to the best of the knowledge and belief of those signing,

> (1) The consolidated financial statements ... are fairly presented in conformity with [GAAP]....
> (18) Other than those disclosed, no events have occurred subsequent to December 31, 2000 that require consideration as adjustments to or disclosures in the consolidated financial statements.
> (19) The Company is responsible for determining and maintaining the adequacy of the allowance for doubtful accounts receivable, chargebacks, rebates, returns and cash discounts as well as estimates used to determine such amounts. Management believes the allowances are adequate to absorb currently estimated uncollectible receivables in the account balances.

The second letter, dated April 17, 2001, represented that, to the best of the knowledge and belief of the signers,

> (1) Other than the events described in paragraph 4 of Note G [relating to an April 6, 2001 amendment of the revolving credit agreement with The Northern Trust Co.], there are no events which have occurred subsequent to February 23, 2001 that have a material effect on the financial statements that are in the filing or that should be disclosed in order to keep those statements from being misleading.

On April 17, 2001, Akorn filed the 2000 Form 10-K in which, as noted above, it reported net income of $2,187,000 and current assets of $42,123,000. Akorn's current assets included $24,144,000 of "trade accounts receivable (less allowance for uncollectibles of [$801,000])."[23] Although sales to the top five wholesaler customers accounted for approximately 60% of Akorn's gross accounts receivable, the allowance for uncollectible accounts did not include any amount related to those customers. Moreover, the Form 10-K did not note any impairment of the receivables. Deloitte understood from McConville and others in Akorn management that the top five wholesaler customers did not present a collection risk because they had both the ability and the intent to pay. In the Independent Auditors' Report, which was included in the Form 10-K, Deloitte repeated the assertion from the February 23, 2001 management representation letter that the consolidated financial statements presented Akorn's financial position fairly, in conformity with GAAP. Deloitte issued an unqualified opinion as to the financials that were part of Akorn's Form 10-K for 2000.[24]

On May 22, 2001, slightly more than a month after filing the Form 10-K, Akorn filed its quarterly report, Form 10-Q, for the quarter ended March 31, 2001. In its Form 10-Q, Akorn increased its allowance for doubtful accounts by $7,520,000. On October 7, 2002, Akorn restated its financial statements for 2000 and 2001 by filing a Form 10-K/A. The

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[23] Akorn appears to have used the terms "allowance for uncollectibles" and "allowance for doubtful accounts" interchangeably. As indicated above, the allowance was reflected on the financial statements as a reduction of the accounts receivable balance; it thus directly affected Akorn's total assets.

[24] McConville did not sign the 2000 Form 10-K.

Form 10-K/A stated that Akorn "had not adequately considered all of the information available with respect to certain disputed receivables in establishing its allowance for uncollectible accounts as of December 31, 2000," that the $7,520,000 increase in its allowance for doubtful accounts should have been recorded at year end 2000 rather than in the first quarter of 2001, and that the bad debt expense in the 2000 financial statement was understated by a corresponding amount. As a result of these adjustments, Akorn's restated financials for 2000 reported a net loss of $2.4 million, or $0.13 per share.

III.

A. McConville violated Section 10(b) and Rule 10b-5.

Exchange Act Section 10(b) makes it unlawful "for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or the mails, ... [t]o use or employ, in connection with the purchase or sale of any security ... any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." Rule 10b-5 prohibits fraud, misleading statements or omissions, and any act, practice or course of business that operates as a fraud "in connection with the purchase or sale of any security." To establish a violation of Section 10(b) and Rule 10b-5, it must be shown that a person acted with scienter, or "a mental state embracing intent to deceive, manipulate, or

defraud."[25] Reckless behavior satisfies the scienter requirement.[26]

1. Akorn's 2000 Form 10-K contained materially misleading statements and omissions.

The financial statements in Akorn's 2000 Form 10-K overstated Akorn's accounts receivable and current assets because its allowance for doubtful accounts did not include any amounts for Akorn's five largest wholesale customers. Additionally, the balance sheet overstated Akorn's accounts receivable, which represented 57% of Akorn's current assets, by failing to note the likelihood of a loss contingency.[27]

As noted above, Akorn's current assets as reported in the 2000 Form 10-K included accounts receivable of approximately $24 million, with 60% of its gross accounts receivable attributable to the top five wholesale customers. With a sum of approximately $5 million to be reconciled between Akorn and Cardinal alone, and with ample evidence that Akorn would not be able to collect on the entire amount it believed it was due, the amounts at issue were material. The material overstatements rendered the financial statements materially false and misleading.

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[25] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

[26] *Id.*, 425 U.S. at 193 n.12.

[27] We do not base our findings as to McConville's liability on the February 20, 2001 press release, even though the press release contained figures that were incorporated into the 2000 Form 10-K. The OIP did not charge misstatements in the press release.

The statement in the Form 10-K that the financial statements were prepared in accordance with GAAP was also materially false and misleading. GAAP includes Statement of Financial Accounting Standards Number 5 ("FAS 5"), which deals with accounting for contingencies. Under FAS 5, a loss contingency is defined as "an existing condition, situation, or set of circumstances involving uncertainty as to possible ... loss ... to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur."[28] Collectibility of receivables is given as an example of a loss contingency.[29] FAS 5, paragraph 8, provides that an estimated loss from a loss contingency must be accrued by a charge to income if two conditions are met:

> a. Information available prior to issuance of the financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
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> b. The amount of loss can be reasonably estimated.[30]If information available prior to issuance of the financial statements indicates that it is probable that an asset has been impaired (satisfying paragraph 8(a)), but the amount of the loss cannot be reasonably estimated (as required

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[28] Financial Accounting Standards Board, Original Pronouncements, vol. I, 34 (FAS 5, par. 1) (2003/2004 edition).

[29] *Id.* (FAS 5, par. 4).

[30] *Id.*, vol. I, 35 (FAS 5, par. 8)

> by paragraph 8(b)), FAS 5 paragraph 10 requires that "disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss ... may have been incurred."[31] "Reasonably possible" is defined as meaning that "[t]he chance of the future event or events occurring is more than remote but less than likely."[32]

Information available before the financial statements were issued on April 17, 2001 demonstrated that it was not only reasonably possible, but probable, that Akorn would fail to collect 100% of the receivables from its top five wholesale customers.[33] Akorn's accounting records as to accounts receivable were in a shambles. Akorn management knew that the receivables were increasingly growing more aged, but it lacked the detailed, accurate reports that would permit a thorough analysis of aging. Akorn was unable to tell which invoices had been paid (or offset by credits), so it could not convincingly demonstrate to its customers what payment was still owed. Because Akorn had not monitored accounts receivable properly for years, it was not able to provide proofs of delivery for some shipments. Akorn knew that reconciling its accounts receivable would be an enormous task. And it knew that the one customer account that it had most thoroughly reviewed, the Cardinal account, still presented significant obstacles to collection, with Cardinal contesting approximately $5 million of the amount Akorn claimed was owing. Thus, even if the amount of loss could

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[31] *Id.*, vol. I, 35-36 (footnote omitted) (FAS 5 par. 10).

[32] *Id.*, vol. I, 34 (FAS 5 par. 3(b)).

[33] FAS 5 states that a future event is "probable" if it is "likely to occur."

not reasonably be estimated by April 17, the likelihood that complete collection would not be possible was sufficiently great that impairment should have been indicated. Because no such impairment was noted, the financial statements were not in accordance with GAAP.[34] Moreover, the failure to disclose that the receivables were impaired was an omission of a material fact necessary to ensure that the figures in the financial statements were not misleading.

2. McConville is liable for the material misrepresentations and omission in Akorn's 2000 Form 10-K.

McConville, as CFO, (working with Costello as controller) oversaw the drafting of the 2000 Form 10-K, and reviewed a draft of the Form 10-K that was virtually identical to the 2000 Form 10-K that Akorn filed with the Commission, which incorporated the fourth-quarter and year-end results that she included in the February 20, 2001 press release that she authored. She also knew that Akorn's allowance for doubtful, or uncollectible, accounts as reported in the Form 10-K did not contain any reserve with respect to Akorn's five largest customers, and that the Form 10-K omitted to disclose any impairment of the accounts receivable. McConville signed the management representation letters reassuring Deloitte that the financial statements were in accordance with

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[34] McConville argues that she did not have adequate notice that the Division's allegations regarding GAAP violations were based on an omitted disclosure concerning Akorn's chargeback and rebate reserves. Since we do not base our finding on this theory, we need not reach this issue. We note, however, that the OIP is replete with references to Akorn's accounts receivable records, and that the treatment of chargebacks and rebates is an aspect of Akorn's accounts receivable accounting.

GAAP and that, with one exception not relevant here,[35] no events had occurred subsequent to February 23, 2001 that had a material effect on the financial statements that are in the filing or that should be disclosed in order to keep those statements from being misleading. At the time she signed the letters, McConville knew, or was reckless in not knowing, that the statements in those letters were false,[36] and that Deloitte would rely on them in issuing the audit opinion that was included in the Form 10-K.

Well before the filing of the Form 10-K on April 17, 2001 McConville knew that Akorn's accounts receivables accounting was in terrible disarray. Akorn's adoption of the Macola and J.D. Edwards software packages happened during McConville's tenure as CFO. She was aware that there were accounts receivable records on each of those systems, and that Macola ran into problems and would not function when processing transactions that involved large volumes of data. She knew that Akorn invoices were lengthy, that remittances were not matched with invoices, and that it was impossible to determine aging patterns accurately. She knew from Deloitte's February 25, 2000 report that Deloitte was concerned about management's failure to review the accounts receivable in

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[35] The subsequent event noted in the April 17 letter was the April 16, 2001 amendment of Akorn's revolving credit agreement with The Northern Trust Company.

[36] The record does not address whether McConville reviewed the draft Form 10-K at the time she signed the representation letters, or at any time after she reviewed the draft that incorporated the erroneous numbers from the February press release. Given the assurances about the financial statements provided in those letters, however, it was at least reckless if McConville did not actually review the documents about which she was making representations.

detail, misapplication of credits and payments to customer accounts, and failure to collect on outstanding balances effectively and efficiently. She also knew that management had undertaken to achieve "significant collection resolution by June 30, 2000 and complete cleanup by August 31, 2000," and she knew that these goals were not accomplished. McConville further knew that as sales were growing, the distribution of the aging of receivables was getting older, and that during 2000, an increasingly large dollar amount was going uncollected for an increasingly long time.[37] McConville knew that her February 2001 meeting with Cardinal resulted in payment by Cardinal of only $913,745 (at a time when she believed that Cardinal owed Akorn approximately $4 million), that after paying the $913,745 Cardinal considered that it was in a credit position with Akorn, and that Akorn's records were in such disarray that Akorn would be unlikely to be able to provide proofs of delivery to substantiate at least some of the allegedly unpaid invoices.

McConville knew that, in part because of computer problems and the volume of paperwork involved, reconciling the accounts receivable would be a monumental task. Moreover, after her February meeting with Cardinal and

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[37] The law judge found McConville's assertion that she did not remember exactly when Akorn's board became concerned about the increased aging of the receivables not credible, since she was responsible for reporting Akorn's financial results to the board and, in 1999 and 2000, Akorn's accounts receivable were increasing at a much faster rate than sales. McConville also prepared the management response to the concerns about accounts receivable expressed by Deloitte in its February 25, 2000 report to Akorn's board. We find that McConville, who attended both board and audit committee meetings, was aware of those concerns well before the 2000 Form 10-K was filed.

Cardinal's response, she knew or was reckless in not knowing that Akorn was not going to be able to collect the entire amount Akorn believed was due from Cardinal and Akorn's other top wholesale customers, and that the failure to collect would adversely impact Akorn's financial statements. Given this knowledge, we find that McConville acted with scienter in connection with her involvement in the preparation and filing of the 2000 Form 10-K.[38]

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[38] McConville argues that the alleged misstatements in the Form 10-K are opinion statements and as such are protected by the "bespeaks caution" doctrine. We assume McConville is relying on the cautionary language contained in Note A to the 2000 Form 10-K, which generally states that the preparation of financial statements requires management to use estimates and assumptions and that actual results could differ materially from estimates. (McConville cites Note G on page 30 of the Form 10-K, but this reference appears to have been an error on her part because Note G, which refers to covenants involved in a revolving credit agreement, is irrelevant to the issues in this case.) The "bespeaks caution" doctrine does not permit a company to avoid Rule 10b-5 liability by the insertion of "boilerplate" cautionary language, like that contained in Note A, into a filing. *See, e.g., In re Trump Casino Sec. Litig.*, 7 F.3d 357, 371-72 (3d Cir. 1993) (boilerplate disclaimer that merely warns that investment has risks will ordinarily be inadequate to prevent misinformation; instead, cautionary statements must be substantive and tailored to specific future projections, estimates, or opinions challenged). Moreover, many of the material misstatements in the Form 10-K are statements of fact rather than opinion, including statements of the Company's annual net sales, net income, and year-end accounts receivable.

3. McConville's misstatements and omissions were "in connection with" the purchase or sale of a security, and the misstatements were made by jurisdictional means.

The filing of false or misleading Forms 10-K with the Commission satisfies the requirement that misstatements or omissions be made "in connection with" the purchase or sale of a security.[39] McConville argues, however, that her involvement in the preparation of the financial statements contained in the Form 10-K was not sufficiently "in connection with" the purchase or sale of a security. McConville argues that statements made to auditors "that might eventually find their way into a document distributed to investors" do not satisfy the "in connection with" requirement.

McConville misperceives the basis of her liability. Her liability under Section 10(b) and Rule 10b-5 is not based on statements to auditors that unexpectedly ended up in documents distributed to investors; it is based on misstatements and omissions in the financial statements contained in the 2000 Form 10-K filed with the Commission, which she was involved in drafting and reviewing.[40] McConville prepared the press release containing the year-end figures that were included in the financial statements contained in the 2000 Form 10-K. She reviewed a draft of the

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[39] *See SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1362 (9th Cir. 1993).

[40] McConville's situation is thus distinguishable from that in *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27 (D.C. Cir. 1987) and *Wessel v. Buhler*, 437 F.2d 279 (9th Cir. 1971), on which she relies.

financial statements as part of the drafting of the 2000 Form 10-K; this draft was virtually identical to the financial statements that were ultimately filed with the Commission. Between March and the April 17 filing of the Form 10-K, her substantial work on the reconciliation of the Cardinal account informed her that a significant portion of Cardinal's receivables would not be collectible. She signed the management representation letters relied on by Deloitte stating that the financial statements were in accordance with GAAP and that no events had transpired that would require adjustments or disclosures in the financial statements. This involvement in the dissemination of false and misleading information to investors was sufficient to satisfy the "in connection with" requirement.

In a similar vein, McConville argues that the violations of Section 10(b) and Rule 10b-5 charged were not established because the record does not show that any of her misleading statements to Deloitte were made by the use of jurisdictional means. However, as discussed above, the misleading statements for purposes of Section 10(b) and Rule 10b-5 are not misstatements to Deloitte, but rather misstatements and omissions in the financial statements contained in the 2000 Form 10-K, which was filed with the Commission by electronic filing, through telephone lines or otherwise across state lines using interstate commerce. Thus, the requirement of use of jurisdictional means was satisfied.[41]

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[41] McConville does not deny that numerous cases find liability under Section 10(b) and Rule 10b-5 against persons who did not personally "push the button" to transmit a filing to the Commission. *See, e.g., Rana Research*, 8 F.3d 1358 (consultant liable under Section 10(b) and Rule 10b-5 for misrepresentations in press release that was transmitted by facsimile by office manager). She contends, however, that those cases do not present a finding of violation by

B. McConville violated Exchange Act Section 13(b)(5) and Rule 13b2-1.

Exchange Act Section 13(b)(5) provides, in relevant part, that "[n]o person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account" described in Section 13(b)(2). Rule 13b2-1 makes it unlawful for a person, directly or indirectly, to falsify or cause to be falsified any book, record, or account subject to Exchange Act Section 13(b)(2)(A). Scienter is not required for a finding of violation of Rule 13b2-1.[42]

As discussed above, Akorn's internal controls fell far short of what would have been necessary for the preparation of accurate financial statements. McConville's tenure as CFO encompassed the period during which Akorn adopted first the Macola, then the J.D. Edwards software programs. She was well aware of the shortcomings of these programs and of the complexity and difficulty of accurately aging the accounts receivable and reconciling Akorn's accounts receivables records with its customers' accounts payable records. Thus, McConville knew that Akorn did not have a system of internal accounting controls for its accounts receivable necessary for the preparation of accurate financial statements

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a person who "properly objects" to the failure of proof that he or she used jurisdictional means in the manner prescribed by Section 10(b) and Rule 10b-5. We cannot discern from the opinions in question whether an objection to the use of jurisdictional means was raised during those proceedings. The cases hold that liability attaches against persons whose involvement was comparable to McConville's.

[42] *SEC v. McNulty*, 137 F.3d 732, 740-41 (2d Cir. 1988).

and knowingly failed to implement such a system, in violation of Section 13(b)(5). Moreover, by failing to correct those shortcomings, McConville caused the falsification of Akorn's records, in violation of Rule 13b2-1.[43]

C. McConville caused Akorn to violate Exchange Act Section 13(b)(2).

Exchange Act Section 13(b)(2)(A) requires, among other things, that every issuer of securities registered with the Commission pursuant to Section 12 make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer. Exchange Act Section 13(b)(2)(B) requires, in relevant part, that every such issuer of securities devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in

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[43] McConville argues that Section 13(b)(5) is silent as to the quality or characteristics of the system of internal accounting controls required and that the standard required under Section 13(b)(2) is inapplicable. McConville cites no authority, and we are aware of none, for the proposition that the term "internal accounting controls" means one thing in one subsection of the statute and something else in another subsection. McConville also argues she cannot be found to have falsified any book or record for purposes of Rule 13b2-1 because she made no entries in Akorn's ledgers and did not know how to make entries into Akorn's computerized accounting system. Rule 13b2-1 does not limit liability to those who directly falsify books and records; it allows persons to be held liable for having indirectly falsified, or caused to be falsified, books and records. McConville's failure to implement a system of internal controls to ensure that transactions were properly recorded establishes her violation of the rule.

accordance with GAAP and to maintain accountability for assets. Scienter need not be shown to establish liability under Section 13(b)(2).[44]

As discussed above, Akorn's accounts receivable records did not accurately show what invoices had been paid or what amounts were still owing on particular invoices and therefore did not accurately and fairly reflect the transactions and disposition of Akorn's assets. The financial statements filed with the 2000 Form 10-K materially overstated Akorn's assets because of the failure to include in the allowance for doubtful accounts anything for the five largest wholesale customer accounts. Additionally, as we have already found, the financial statements in the 2000 Form 10-K were not in accordance with GAAP because they failed to disclose the impairment of the accounts receivable. The inaccuracies in the accounts receivable were due to Akorn's inadequate internal controls, as discussed above. Akorn violated Section 13(b)(2) by failing to keep records that accurately and fairly reflected the transactions and dispositions of its assets, and by failing to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions were recorded as necessary to permit preparation of financial statements in accordance with GAAP and to maintain accountability for assets.

McConville can be found to have caused Akorn's violations of Section 13(b)(2) if she was responsible for an act or omission that she knew or should have known would

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[44] *See McNulty*, 137 F.3d at 740-41 (citing authorities).

contribute to the violation.[45] As discussed above, McConville knew or was reckless in not knowing that her failure to implement more adequate internal controls would result in inaccuracies in Akorn's books and records, and we thus find that McConville caused Akorn's violations of Section 13(b)(2).[46]

McConville contends that Akorn's books, records, and accounts satisfied Section 13(b)(2)(A) because they did reflect the transactions and dispositions of Akorn's assets "in reasonable detail," as the statute requires. She contends that the evidence does not show any deliberate falsification of accounting entries; she argues that at most, it shows that Akorn's bookkeepers did not fully process remittance advices on as timely a basis as was desirable and that the accounts receivable personnel were less diligent than was desirable in pursuing collections.

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[45] Exchange Act Section 21C; *see Robert M. Fuller*, Exchange Act Rel. No. 48406 (Aug. 25, 2003), 80 SEC Docket 3539, 3545, *pet. for review denied*, No. 03-1334 (D.C. Cir. Apr. 23, 2004); *Erik W. Chan*, Exchange Act Rel. No. 45693 (Apr. 4, 2002), 77 SEC Docket 851, 859-60. Contrary to McConville's argument, the Division was not required to prove that her conduct was a proximate cause of the violations.

[46] McConville argues that Costello, or persons who reported to Costello, were responsible for the making and keeping of Akorn's books and records and that McConville therefore cannot be held liable for the violations of Section 13(b)(2)(A) charged. But Costello reported to McConville, and McConville testified that she "indirectly ... was responsible for supervising the day-to-day financial operations of the company." Having taken on these responsibilities, McConville cannot evade the consequences of her failure to fulfill them appropriately.

We reject McConville's characterization of the evidence. The magnitude of the problem went far beyond the description she offers. As Maire noted, problems with Akorn's accounts receivable had been accumulating over a three- to four-year period, with "pages and pages of A/R reports" on each of the top five wholesaler accounts, consisting of a "maze of transactions" going back as far as 1996. This description is not one of books and records that accurately reflect transactions and disposition of assets "in reasonable detail."

McConville argues that the GAAP violation charged was "wholly unrelated to Akorn's internal accounting controls" because "the propriety of disclosure [of the impairment of receivables] and creation of additional reserves would turn on a judgment call as to whether Akorn's customers would duly pay submitted invoices," a judgment as to which, she contends, internal controls are irrelevant. We disagree. Any "judgment call" that Akorn might make about whether its customers would pay must depend heavily on the quality of the information on which the judgment is based. The quality of that information depended, in turn, on its internal controls. If Akorn did not know how much of which invoices remained unpaid, it was in a poor position to judge how much it was likely to collect. Moreover, the question whether customers could be expected to pay invoices depends in significant part on how well substantiated those invoices were. If Akorn could not match payments or credits to invoices in order to prove how much was due, and if it could not produce on demand proof of delivery, then it could not expect customers to pay. Additionally, older invoices may be more difficult to collect. The inadequacy of Akorn's internal controls made it impossible to track the aging of receivables in detail and therefore were not sufficient to provide reasonable assurances that transactions were recorded as necessary to permit

preparation of financial statements in accordance with GAAP and to maintain accountability for assets, as required by Section 13(b)(2).[47]

D. McConville violated Rule 13b2-2.

Rule 13b2-2, in relevant part, makes it unlawful for an officer of an issuer to make or cause to be made a materially false or misleading statement to an accountant or omit or cause another person to omit any material information necessary to make the statements made not misleading in connection with an audit of financial statements or reports

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[47] McConville argues that, if the financial statements in the 2000 Form 10-K did not conform to GAAP because of failure to disclose an impairment of Akorn's receivables, the GAAP violation was "not caused by deficiencies in Akorn's internal controls," but rather "caused by a failure of Akorn's accountants to assure that the potential impact of the shortcomings in Akorn's internal controls was properly disclosed." McConville's argument would recast Section 13(b)(2)(B) as a statute about disclosure and shift the blame to Akorn's auditors. Neither argument is persuasive. Section 13(b)(2)(B) is about the adequacy of internal accounting controls. The conduct of Akorn's auditors is not at issue in this proceeding.

McConville contends that Exchange Act Section 13(b)(2) is "unconstitutionally vague," citing *SEC v. World-Wide Coin Investments, Ltd.*, 567 F.Supp. 724, 751 (N.D. Ga. 1983), a case that, in relevant part, concerns the applicability of the internal control provisions of Section 13(b)(2)(B). *World-Wide Coin* does not address whether Section 13(b)(2)(B) is unconstitutionally vague. It simply states that "[a]ny ruling by a court with respect to the applicability of both the accounting provisions and the internal accounting control provisions should be strictly limited to the facts of each case." We have engaged in precisely that type of fact-sensitive analysis here.

filed with the Commission. The term "officer" includes a "comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization whether incorporated or unincorporated."[48] We have already found that the management representation letters signed by McConville and addressed to Deloitte contained false statements about the conformity of the financial statements with GAAP, the adequacy of the allowance for uncollectible accounts receivable, and the lack of need for further disclosures. We also find that McConville falsely represented to Deloitte that indications were positive in terms of receivables and that there was little past due money owing from wholesalers because most of the old bills were offset by more recent credits. By making these false representations to Deloitte, McConville violated Rule 13b2-2.

McConville contends that she cannot be liable for the violation of Rule 13b2-2 because at the time of the alleged misstatements she was Akorn's "Corporate Controller," not its "comptroller." The securities laws are to be construed broadly to effectuate their remedial purpose.[49] "Controller" and "comptroller" may be used interchangeably to describe the position in an agency or organization with oversight responsibilities for the agency's or organization's primary accounting functions.[50] McConville's responsibilities, insofar

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[48] Exchange Act Rule 3b-2, 17 C.F.R. § 240.3b-2.

[49] *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963).

[50] Disclosure Required By Sections 404, 406 and 407 of the Sarbanes-Oxley Act of 2002, Securities Act Rel. No. 8138 (Oct. 22, 2002), 78 S.E.C. Docket 2270, 2273 n.46; *see also Albert Glenn Yesner*, Initial Decision No. 184 (May 22, 2001), 75 S.E.C.

as they related to the signing of the management representation letters, were commensurate with those of an officer.[51]

E. McConville caused Akorn to violate Exchange Act Section 13(a) and Rules 13a-1 and 12b-20.

Section 13(a) and Rule 13a-1 require the filing of annual reports with the Commission. The contents of those reports must be complete and accurate.[52] Rule 12b-20 mandates that periodic reports contain such further material information as may be necessary to make the required statements not misleading.[53]

We have already found that Akorn's 2000 Form 10-K was inaccurate in that the current assets were materially overstated and that the impairment of the receivables should have been, but was not, disclosed. For the reasons set forth in finding

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Docket 220, 265 ("[C]ontroller is synonymous with comptroller.").

[51] *Albert Glenn Yesner*, on which McConville relies, is distinguishable on the facts. While a law judge found that Yesner was not an officer for purposes of Rule 3b-2, Yesner was not a primary contact for his employer's accountants and was not involved in the preparation of filings. *Yesner*, 75 S.E.C. Docket at 265-66. Moreover, Yesner did not sign any management representations letters, as did McConville.

[52] *SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978); *SEC v. IMC Int'l, Inc.*, 384 F. Supp. 889, 893 (N.D. Tex.), *aff'd mem.*, 505 F.2d 733 (5th Cir. 1974).

[53] 17 C.F.R. § 240.12b-20. Violations of Section 13(a) or of the Commission's rules thereunder do not require scienter. *McNulty*, 137 F.3d at 740-41.

that McConville violated Section 10(b), we find that she caused Akorn to violate Section 13(a) and Rules 13a-1 and 12b-20.

F. McConville's procedural arguments are without merit.

McConville makes two related arguments that her due process rights were violated because she did not have adequate notice of the charges against her. First, she argues that the law judge erred in refusing to grant her motion for a more definite statement. Second, she claims that, because the law judge denied her motion to strike evidence and proffered findings relating to Akorn's chargeback and rebate reserves, the Division was able to present evidence outside the scope of the OIP of which she did not have notice. These arguments are without merit.

Our rules require that the OIP set forth the factual and legal basis alleged for the order "in such detail as will permit a specific response thereto."[54] The OIP must inform the respondent of the charges in enough detail to allow the respondent to prepare a defense, but it need not disclose to the respondent the evidence upon which the Division intends to rely.[55]

The OIP in this proceeding alleged facts regarding McConville's employment at Akorn, her knowledge regarding

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[54] Rule of Practice 200(b)(3), 17 C.F.R. § 201.200(b)(3).

[55] *J. Logan & Co.*, 38 S.E.C. 827 (1959); *Charles M. Weber*, 35 S.E.C. 79 (1953). McConville does not dispute that she had access to the Division's investigatory record, which provided information about the evidence on which the Division intended to rely.

deficiencies and problems related to Akorn's accounts receivable records, her review of the 2000 Form 10-K, the failure to create a reserve for Akorn's largest customer accounts receivable, her false statements in the management representation letters, her failure to make certain disclosures regarding accounts receivable to Akorn's auditors, the increase in the reserve for doubtful accounts in the 10-Q for the first quarter of 2001, and the statutes and rules violated. The OIP also put McConville on notice that Akorn's accounting for chargebacks and rebates would be an issue in the proceeding.[56] The OIP thus satisfied the due process requirement that a respondent be given fair notice of the claims lodged and the grounds upon which those claims rest, and the law judge did not err in denying her motion.[57]

McConville makes several additional unsubstantial procedural arguments. For example, McConville argues that, because Commission sanctions are "quasi-criminal," the Division was required to prove its case by clear and convincing evidence. Under *Steadman v. SEC* it is well settled that the applicable standard, which we applied here, is preponderance of the evidence.[58]

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[56] *See supra* note 33.

[57] *See, e.g., Jaffee & Co. v. SEC*, 446 F.2d 387, 394 (2d Cir. 1971). McConville complains that the law judge denied her motion before considering her reply memorandum. The law judge reconsidered her ruling after considering McConville's reply and the cases cited therein. She then denied McConville's motion. McConville does not identify any prejudice that resulted from the law judge's ruling, and we see none.

[58] *Steadman v. SEC*, 450 U.S. 91, 103 (1980).

McConville asserts that the Commission's settled administrative proceeding against Costello, who served as Akorn's controller during much of McConville's tenure as CFO, collaterally estops the Commission from finding that she committed the violations charged because the order in that proceeding found that Costello had significant responsibility for the preparation and contents of Akorn's 2000 Form 10-K.[59] The doctrine of collateral estoppel protects litigants from relitigating an identical issue with the same party.[60] The question whether McConville had significant responsibility for preparing the 2000 Form 10-K is not identical to the question whether Costello also had significant responsibility for that document, so it is not being relitigated here.[61]

McConville argues that the amended financial statements for fiscal year 2000 contained in the Form 10-K/A filed by Akorn on October 7, 2002 "represent the only concrete evidence of a quantifiable deficiency in the reserve for doubtful accounts" in Akorn's 2000 Form 10-K, and that "to the extent the Initial Decision suggests that such a quantifiable deficiency existed on April 17, 2001, that suggestion rests on the erroneous admission of prior sworn testimony -- the Form 10-K/A -- representing an official change in Akorn's position

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[59] *Thomas D. Costello*, Exchange Act Rel. No. 48906 (Dec. 11, 2003), 81 SEC Docket 3151.

[60] *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 326-27 (1979).

[61] McConville argues that the law judge "turned the principle of collateral estoppel on its head" and used the Costello order improperly against her. The import of this argument is unclear, but in any event, our de novo review would cure any error of this nature.

into which McConville had no input." She goes on to argue that, insofar as the Form 10-K/A represented prior sworn testimony, its admission was governed by our Rule 235; that the requirements of Rule 235 were not satisfied; and that the admission of the Form 10-K/A therefore "violated McConville's Sixth Amendment rights."

McConville's argument is flawed in many respects. To the extent the law judge made "suggestions," such "suggestions" are now irrelevant in light of our de novo review.[62] We see nothing in the Initial Decision that suggests that the law judge based any conclusions on a finding that there was a quantifiable deficiency in the reserve for doubtful accounts as of April 17, 2001. We make no such finding, and we base no conclusion on any such finding. None of the numbers contained in the Form 10-K/A are the basis for any finding against McConville. We do not find that the amount of uncollectible receivables could be quantified by April 17; we find, however, that McConville knew or was reckless in not knowing that it was likely that Akorn would fail to collect a substantial amount of the receivables from the top five wholesale customers. In any event, Rule 235 is irrelevant to the admission of the Form 10-K/A, a filing with the Commission, and compliance with the requirements of Rule

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[62] In a further argument of this nature, McConville contends that the law judge relied on facts and arguments not explicitly identified in the Initial Decision. McConville fails to identify any portions of the Initial Decision that the law judge failed to support with references to specified facts. But again, any errors of this sort in the Initial Decision are of no consequence since our review is de novo.

235 is consequently irrelevant. The Sixth Amendment is irrelevant to non-criminal proceedings.[63]

IV.

Exchange Act Section 21C authorizes the Commission, where there is a finding that a person has violated or caused a violation of a provision of the Exchange Act or any rule thereunder, to order such person to cease and desist from committing or causing such violation and any future violation of the same provision or rule.[64] In determining whether a cease-anddesist order is an appropriate sanction, we look to the risk of future violations and a variety of other factors, including the seriousness of the violation, the isolated or recurrent nature of the violation, whether the violation is

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[63] McConville argues that the law judge improperly quashed her subpoena requiring the Commission to produce certain materials related to its dealings with Akorn leading to the filing of the Form 10-K/A. As noted above, however, none of the numbers in the Form 10-K/A are the basis for any finding against McConville.

[64] 15 U.S.C. § 78u-3. The law judge ordered McConville to pay disgorgement, based on the salary she received from Akorn in 2000 and 2001. Although we believe that imposing disgorgement of salary is within our authority, as an exercise of discretion, we decline to do so here.

Our resolution of this matter makes it unnecessary to reach the question of McConville's alleged inability to pay disgorgement. McConville submitted a Form D-A, containing personal financial information. We grant her unopposed motion pursuant to Rule of Practice 322(b), 17 C.F.R. § 201.322(b), for a protective order for the financial information contained in this Form, based on our finding that the harm to McConville resulting from disclosure would outweigh the benefits of disclosure.

recent, the degree of harm to investors or the marketplace resulting from the violation, the respondent's state of mind, the sincerity of assurances against future violations, recognition of the wrongful nature of the conduct, opportunity to commit future violations, and remedial function to be served by the cease-and-desist order in the context of any other sanctions sought in the proceeding.[65] We impose a cease-and-desist order only where we have determined that there is some risk of future violation.[66]

The violations here were significant. McConville was responsible for misrepresentations and omissions in Akorn's Form 10-K, which was filed with the Commission and thus made available to investors. As a result of the deficiencies in Akorn's recordkeeping and internal controls, Akorn's receivables were overstated, no impairment of the receivables was disclosed, and no reserve was created for customer accounts that represented 60% of the receivables. McConville made misrepresentations to Deloitte in the management representation letters to Deloitte, knowing that Deloitte would be basing assumptions on those letters in its work on the 2000 audit. She also made oral misrepresentations to Deloitte about the collectibility of the receivables from the top five wholesale customers.

The deficiencies of Akorn's recordkeeping with regard to accounts receivable was an ongoing problem, not a one-time

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[65] *KPMG Peat Marwick*, 54 S.E.C. 1134, 1192 (2001), *reconsideration denied*, 74 SEC Docket 1351 (Mar. 8, 2001), *pet. for review denied*, 289 F.3d 109 (D.C. Cir. 2002).

[66] *KPMG Peat Marwick*, 54 S.E.C. at 1185. The risk of future violations required to support a cease-and-desist order is significantly less than that required for an injunction. *Id.* at 1191.

or limited occurrence. The situation deteriorated for months, if not years, and McConville failed to take adequate action to improve matters. The violations were relatively recent: the deficiencies in internal controls became more pronounced over the years and came to a head in 2000 and early 2001, and McConville signed the management representation letters in 2001, and the 2000 Form 10-K was filed in 2001.

McConville's actions caused harm to investors and the marketplace. Fraudulent misstatements and omissions in financial statements and periodic reports mislead investors who buy or sell stock based on the information contained therein. Moreover, exposure of the fraud results in an erosion of confidence in the marketplace in general.[67]

As we found above, McConville acted with scienter. McConville continues to deny responsibility for the violations charged, and does not acknowledge any wrongdoing on her part. Her primary assurance that she will not commit future violations is based on the fact that the bringing of this proceeding against her has damaged her reputation to such an extent that it is unlikely that she will be hired for a position where she could commit such violations. However, merely instituting a proceeding does not preclude future employment in the securities industry. A cease-and-desist order will serve the remedial purpose of encouraging McConville to take her

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[67] *See, e.g., SEC v. Dresser Indus., Inc.*, 628 F.2d 1368, 1377 (D.C. Cir. 1980) (dissemination of false or misleading information by companies to members of investing public may distort efficient workings of securities markets and injure investors who rely on the accuracy and completeness of company's public disclosures).

responsibilities more seriously in the future.[68] We find that the record as a whole, especially the evidence with regard to the seriousness of McConville's violations and her lack of acknowledgement of wrongdoing, establishes a sufficient risk that McConville would commit future violations to warrant imposition of a cease-and-desist order. Based on all of these factors, we find a cease-and-desist order to be in the public interest.[69]

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[68] *See McCurdy v. SEC*, 396 F.3d 1258, 1265 (D.C. Cir. 2005) (recognizing that order suspending auditor from practice before the Commission for one year had remedial purpose of encouraging more rigorous compliance with generally accepted auditing standards in future).

[69] McConville suggests that under Section 21C of the Exchange Act, the Commission may not enter a cease-and-desist order against McConville because the OIP did not also charge Akorn, the primary violator. McConville argues that Section 21C's use of the singular "*an* order" indicates that cease-and-desist orders are permitted only where such an order also is entered against the primary violator.

The Commission has never construed Section 21C as having such a requirement. *See, e.g. Robert M. Fuller*, 80 SEC Docket 3539 (entering cease-and-desist order for causing violations of primary violator, where no cease-and-desist order was imposed on primary violator). To the contrary, the language in Section 21C providing that the Commission "may" enter a cease-and-desist order against a primary violator and against a person that is a cause of the violation supports our view that the Commission has the option of entering a cease-and-desist order against an individual who causes a violation without entering the same order against the primary violator.

An appropriate order will issue.[70]

By the Commission (Chairman DONALDSON and Commissioners GLASSMAN, GOLDSCHMID, CAMPOS, and ATKINS).

Jonathan G. Katz
Secretary

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[70] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 51950 / June 30, 2005

ACCOUNTING AND AUDITING ENFORCEMENT
Rel. No. 2271 / June 30, 2005

Admin. Proc. File No. 3-11330

In the Matter of	)
RITA J. MCCONVILLE	)
	)

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day it is

ORDERED that Rita J. McConville cease and desist from committing or causing any violations or future violations of Sections 10(b) and 13(b)(5) of the Securities Exchange Act of 1934 and Rules 10b-5, 13b2-1, and 13b2-2 thereunder, and from causing any violations or future violations of Sections 13(a) and 13(b)(2) of the Securities Exchange Act of 1934 and Rules 12b-20 and 13a-1 thereunder.

By the Commission.

Jonathan G. Katz
Secretary

APPENDIX D

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-11330

[Filed November 12, 2003]

In the Matter of	)
	)
Rita J. McConville	)
and	)
Kevin M. Harris, C.P.A.	)
	)
Respondents.	)
	)

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e)(1)(iii) OF THE COMMISSION'S RULES OF PRACTICE

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange

Act") against Rita J. McConville and Kevin M. Harris (collectively, "Respondents"), and also deems it appropriate that proceedings be, and hereby are, instituted pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice[71] against Harris.

II.

As the result of an investigation, the Division of Enforcement alleges that:

A. Akorn, a Louisiana corporation headquartered in Buffalo Grove, Illinois, manufactures and markets diagnostic and therapeutic pharmaceuticals, surgical instruments and related products and provides contract manufacturing services. During the relevant time period and through June 25, 2002, Akorn's stock traded on the Nasdaq National Market System ("Nasdaq"). On June 25, 2002, Akorn's stock was delisted from Nasdaq based on the company's inability to provide audited financial statements in its 2001 Form 10-K, filed on April 16, 2002.

B. Rita J. McConville, 44, of Hawthorn Woods, Illinois, was Akorn's chief financial officer ("CFO") from February 28, 1997 to March 20, 2001. Akorn's board of directors

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[71] Rule 102(e)(1)(iii) provides, in relevant part, that:

The Commission may deny, temporarily or permanently, the privilege of appearing or practicing before it any person who is found...to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities law or the rules or regulations thereunder.

demoted her to controller on March 21, 2001, and she resigned from the company on July 13, 2001.

C. Kevin M. Harris, 41, of Rolling Meadows, Illinois, was Akorn's CFO from March 20, 2001 to September 2001. Prior to that time, beginning in February 2001, he assisted Akorn in various accounting matters.

D. McConville engaged in accounting fraud by drafting and reviewing Akorn's financial statements that she had no reasonable basis to believe were accurate or in accordance with generally accepted accounting principles.

E. Beginning in at least 2000 to at least April 2001, McConville knew that Akorn failed to promptly and accurately record and reconcile cash and credit remittances to invoices posted in its accounts receivable sub-ledger. Akorn's problems resulted from numerous internal control and books and records deficiencies that prevented the company from accurately recording, reconciling, and aging its receivables.

F. McConville knew that Akorn's accounts receivable deteriorated in 2000 and that reconciling accounts receivable was a laborious, time-consuming process.

G. In late February 2001, two months before Akorn filed its 2000 Form 10-K, Akorn's auditors prepared a detailed summary of Akorn's unreconciled accounts receivable in furtherance of its end of the year audit for 2000. Akorn's auditors discussed the results of the analysis with McConville prior to Akorn's filing of its 2000 Form 10-K.

H. On April 17, 2001, Akorn filed its Form 10-K for the year ended December 31, 2000, reporting annual net sales of $66.9 million and net income of $2.2 million or $0.11 per

share. Akorn reported year-end accounts receivable totaling $24.1 million, its largest asset. Despite Akorn's substantial problems with properly recording, reconciling and collecting its accounts receivable throughout 2000 and first quarter 2001, Respondents did not establish a reserve for any of Akorn's accounts receivable for its largest customers during fiscal year 2000, nor did Respondents disclose in Akorn's 2000 Form 10-K any impairment of those receivables. Had Akorn appropriately recorded a reserve for its doubtful accounts, it would have posted a $2 million loss for its fiscal year ended December 31, 2000, rather than the $2 million profit it claimed in its 2000 Form 10-K.

I. McConville reviewed a draft of the Form 10-K, which did not differ significantly from the final Form 10-K filed with the Commission. Harris drafted the text and footnotes related to Akorn's debt covenants with its lender and the refinancing of its credit agreement, and he signed the Form 10-K.

J. Respondents did not have any method for calculating a reserve with respect to Akorn's largest customer accounts receivable, nor did they ever create such a reserve despite Akorn's troubled accounts receivable history.

K. In a representation letter to Akorn's auditors regarding the audit of Akorn's 2000 financial statements, Respondents acknowledged that the company "is responsible for determining and maintaining the adequacy of the allowance for doubtful accounts receivable" and represented that "the allowances are adequate to absorb currently estimated uncollectable receivables in the account balances." Harris and McConville signed this representation letter, as well as a subsequent representation letter to Akorn's auditors dated April 17, 2001, knowing it to be false. In this second letter,

Respondents falsely represented that "no events had occurred [since February 23, 2001] that have a material effect on the financial statements that are in the filing [the 2000 Form 10-K] or that should be disclosed in order to keep those statements from being misleading."

L. Respondents did not tell the auditors about the true condition of Akorn's accounts receivable, despite the Respondents' knowledge of a consultant's conclusions in March 2001 that he could not determine the collectibility of Akorn's accounts receivable and the magnitude of a potential write-off. McConville also knew that there was a substantial discrepancy regarding the amount owed by its largest customer of approximately $5 million, but did not inform Akorn's auditors. Moreover, Respondents failed to disclose to the auditors that the Respondents' assumption that Akorn's customers paid older invoices first and the oldest invoices therefore would be eliminated by a reconciliation process was not supported by the reconciliation process.

M. On May 16, 2001, one month after filing its 2000 Form, 10-K, Akorn issued a press release announcing that the company was evaluating the extent to which it would need to make changes to its financial statement reserves, including its bad debt reserve, and that the changes would have a significant and adverse impact on earnings. The price of Akorn common stock dropped from $3.0937 to $1.7343 per share the day of the announcement, while the volume increased from an average of 70,280 shares per day in the prior five trading days to 1,092,500 shares on May 16, 2001.

N. In its first quarter Form 10-Q, filed on May 22, 2001, Akorn increased its reserve for doubtful accounts by $7.5 million or 10 percent of reported net sales for fiscal year 2000 and 126 percent of reported net sales for the first quarter

2001. The per share impact for the quarter was ($0.39). Following Akorn's filing, the price of Akorn's common stock declined further to close at $1.0937 on May 22, 2001, and $1.125 on May 23, 2001. Akorn explained the increase in its accounts receivable reserve as resulting from a change in estimate solely "[b]ased upon its recent unsuccessful efforts to collect past due balances." Akorn did not disclose anything about its lack of internal controls or its failure to accurately compute, age and monitor its accounts receivable. Harris misrepresented to the auditors that the increase in Akorn's accounts receivable reserve resulted from a change in estimate solely "[b]ased upon its recent unsuccessful efforts to collect past due balances." Harris did not disclose to the auditors that a large portion of the reserve increase resulted from Akorn's failure to accurately compute, age and monitor its accounts receivable.

O. Harris calculated the accounts receivable reserve and drafted the Form 10-Q for the first quarter 2001. Harris did not disclose, however, the composition of Akorn's reserve account in the Form 10-Q. The reserve was calculated based upon 100 percent of Akorn's entire accounts receivable for the years 1999 and prior and 50 percent of its entire accounts receivable for 2000.

P. By virtue of the conduct described in paragraphs II-A through O: (a) McConville violated Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1 and 13b2-2 thereunder and caused Akorn's violations of Sections 13(a) and 13(b)(2) of the Exchange Act and Rules 12b-20 and 13a-1 thereunder; and (b) Harris willfully violated Rule 13b2-2 under the Exchange Act, and caused and willfully aided and abetted Akorn's violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II-A through O hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defense to such allegations;

B. Whether pursuant to Section 21C of the Exchange Act, McConville and/or Harris should be ordered to cease and desist from committing or causing any violations and any future violations of any or all of the Sections or Rules specified in Section II.P. above;

C. Whether McConville and/or Harris should be ordered to pay disgorgement pursuant to Section 21C(e) of the Exchange Act; and

D. Whether pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice, Harris should be censured or denied, temporarily or permanently, the privilege of appearing or practicing before the Commission.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than thirty (30) days and not later than sixty (60) days from service of this Order, at a time and place to be fixed and before an Administrative Law Judge

to be designated by further order, as provided by Rule 200 of the Commission's Rules of Practice, 17 C.F.R. §201.200.

IT IS FURTHER ORDERED that each Respondent shall file an answer to the allegations contained in this Order within 20 days after service this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. §201.220.

If any Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, that Respondent may be deemed in default and the proceedings may be determined against such Respondent upon consideration of this Order, the allegations of which maybe deemed to be true as provided by Rules 155(a), 220(f), and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f) and 201.310.

This Order shall be served upon each Respondent personally, or by certified mail forthwith.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceedings will be permitted to participate or advise in the decision upon this matter, except as witnesses or counsel in proceedings held pursuant to notice. Since this proceeding is not "rulemaking" within the meaning of Section 4(c) of the Administrative Procedure Act, it is not deemed

subject to the provisions of that Section delaying the effective date of any final Commission action.

By the Commission.

Jonathan G. Katz
Secretary

APPENDIX E

STATUTES AND REGULATIONS

15 U.S.C. § 78j
Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--

(a)(1) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(2) Paragraph (1) of this subsection shall not apply to security futures products.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rules promulgated under subsection (b) of this section that prohibit fraud, manipulation, or insider trading (but not rules imposing or specifying reporting or recordkeeping requirements, procedures, or standards as prophylactic measures against fraud, manipulation, or insider trading), and judicial precedents decided under subsection (b) of this section and rules promulgated thereunder that prohibit fraud, manipulation, or insider trading, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities. Judicial precedents decided under section 77q(a) of this title and sections 78i, 78o, 78p, 78t, and 78u-1 of this title, and judicial precedents decided under applicable rules promulgated under such sections, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities.

15 U.S.C. § 78m
Periodical and other reports
(in relevant part)

(a) Reports by issuer of security; contents

Every issuer of a security registered pursuant to section 78l of this title shall file with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security--

(1) such information and documents (and such copies thereof) as the Commission shall require to keep reasonably current the information and documents required to be included in or filed with an application or registration statement filed pursuant to section 78l of this title, except that

the Commission may not require the filing of any material contract wholly executed before July 1, 1962.

(2) such annual reports (and such copies thereof), certified if required by the rules and regulations of the Commission by independent public accountants, and such quarterly reports (and such copies thereof), as the Commission may prescribe.

Every issuer of a security registered on a national securities exchange shall also file a duplicate original of such information, documents, and reports with the exchange.

(b) Form of report; books, records, and internal accounting; directives

(1) The Commission may prescribe, in regard to reports made pursuant to this chapter, the form or forms in which the required information shall be set forth, the items or details to be shown in the balance sheet and the earning statement, and the methods to be followed in the preparation of reports, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of separate and/or consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer; but in the case of the reports of any person whose methods of accounting are prescribed under the provisions of any law of the United States, or any rule or regulation thereunder, the rules and regulations of the Commission with respect to reports shall not be inconsistent with the requirements imposed by such law or rule or regulation in respect of the

same subject matter (except that such rules and regulations of the Commission may be inconsistent with such requirements to the extent that the Commission determines that the public interest or the protection of investors so requires).

(2) Every issuer which has a class of securities registered pursuant to section 78l of this title and every issuer which is required to file reports pursuant to section 78o(d) of this title shall--

(A) make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer;

(B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that--

(i) transactions are executed in accordance with management's general or specific authorization;

(ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;

(iii) access to assets is permitted only in accordance with management's general or specific authorization; and

(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences; and

(C) notwithstanding any other provision of law, pay the allocable share of such issuer of a reasonable annual accounting support fee or fees, determined in accordance with section 7219 of this title.

(3)(A) With respect to matters concerning the national security of the United States, no duty or liability under paragraph (2) of this subsection shall be imposed upon any person acting in cooperation with the head of any Federal department or agency responsible for such matters if such act in cooperation with such head of a department or agency was done upon the specific, written directive of the head of such department or agency pursuant to Presidential authority to issue such directives. Each directive issued under this paragraph shall set forth the specific facts and circumstances with respect to which the provisions of this paragraph are to be invoked. Each such directive shall, unless renewed in writing, expire one year after the date of issuance.

(B) Each head of a Federal department or agency of the United States who issues a directive pursuant to this paragraph shall maintain a complete file of all such directives and shall, on October 1 of each year, transmit a summary of matters covered by such directives in force at any time during the previous year to the Permanent Select Committee on Intelligence of the House of Representatives and the Select Committee on Intelligence of the Senate.

(4) No criminal liability shall be imposed for failing to comply with the requirements of paragraph (2) of this subsection except as provided in paragraph (5) of this subsection.

(5) No person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or

knowingly falsify any book, record, or account described in paragraph (2).

(6) Where an issuer which has a class of securities registered pursuant to section 78l of this title or an issuer which is required to file reports pursuant to section 78o(d) of this title holds 50 per centum or less of the voting power with respect to a domestic or foreign firm, the provisions of paragraph (2) require only that the issuer proceed in good faith to use its influence, to the extent reasonable under the issuer's circumstances, to cause such domestic or foreign firm to devise and maintain a system of internal accounting controls consistent with paragraph (2). Such circumstances include the relative degree of the issuer's ownership of the domestic or foreign firm and the laws and practices governing the business operations of the country in which such firm is located. An issuer which demonstrates good faith efforts to use such influence shall be conclusively presumed to have complied with the requirements of paragraph (2).

(7) For the purpose of paragraph (2) of this subsection, the terms "reasonable assurances" and "reasonable detail" mean such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs.

* * * *

15 U.S.C. § 78u-3 Cease-and-desist proceedings
(in relevant part)

(a) Authority of Commission

If the Commission finds, after notice and opportunity for hearing, that any person is violating, has violated, or is about to violate any provision of this chapter, or any rule or

regulation thereunder, the Commission may publish its findings and enter an order requiring such person, and any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation. Such order may, in addition to requiring a person to cease and desist from committing or causing a violation, require such person to comply, or to take steps to effect compliance, with such provision, rule, or regulation, upon such terms and conditions and within such time as the Commission may specify in such order. Any such order may, as the Commission deems appropriate, require future compliance or steps to effect future compliance, either permanently or for such period of time as the Commission may specify, with such provision, rule, or regulation with respect to any security, any issuer, or any other person.

* * * *

15 U.S.C. § 78y Court review of orders and rules
(in relevant part)

(a) Final Commission orders; persons aggrieved; petition; record; findings; affirmance, modification, enforcement, or setting aside of orders; remand to adduce additional evidence

(1) A person aggrieved by a final order of the Commission entered pursuant to this chapter may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a

written petition requesting that the order be modified or set aside in whole or in part.

(2) A copy of the petition shall be transmitted forthwith by the clerk of the court to a member of the Commission or an officer designated by the Commission for that purpose. Thereupon the Commission shall file in the court the record on which the order complained of is entered, as provided in section 2112 of Title 28 and the Federal Rules of Appellate Procedure.

(3) On the filing of the petition, the court has jurisdiction, which becomes exclusive on the filing of the record, to affirm or modify and enforce or to set aside the order in whole or in part.

(4) The findings of the Commission as to the facts, if supported by substantial evidence, are conclusive.

(5) If either party applies to the court for leave to adduce additional evidence and shows to the satisfaction of the court that the additional evidence is material and that there was reasonable ground for failure to adduce it before the Commission, the court may remand the case to the Commission for further proceedings, in whatever manner and on whatever conditions the court considers appropriate. If the case is remanded to the Commission, it shall file in the court a supplemental record containing any new evidence, any further or modified findings, and any new order.

* * * *

17 C.F.R. § 240.10b-5
Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.12b-20
Additional information

In addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.

17 C.F.R. § 240.13a-1
Requirements of annual reports

Every issuer having securities registered pursuant to section 12 of the Act (15 U.S.C. 78l) shall file an annual report on the appropriate form authorized or prescribed

therefor for each fiscal year after the last full fiscal year for which financial statements were filed in its registration statement. Annual reports shall be filed within the period specified in the appropriate form.

17 C.F.R. § 240.13b2-1
Falsification of accounting records

No person shall directly or indirectly, falsify or cause to be falsified, any book, record or account subject to Section 13(b)(2)(A) of the Securities Exchange Act.

17 C.F.R. § 240.13b2-2
Representations and conduct in connection with the preparation of required reports and documents.
(in relevant part)

(a) No director or officer of an issuer shall, directly or indirectly:

(1) Make or cause to be made a materially false or misleading statement to an accountant in connection with; or

(2) Omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading, to an accountant in connection with:

(i) Any audit, review or examination of the financial statements of the issuer required to be made pursuant to this subpart; or

(ii) The preparation or filing of any document or report required to be filed with the Commission pursuant to this subpart or otherwise.

* * * *